FALL 2021

# Advice **Matters**

**03**

## HOW INFLATION IMPACTS YOUR FINANCIAL FUTURE

INFLATION HAS DOMINATED THE HEADLINES LATELY. LEARN ABOUT THE IMPACT OF INFLATION AND HOW YOU CAN MINIMIZE ITS EFFECTS.

ScotiaAdvice+

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# Advice **Matters**

Presented by

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A simple conversation today can help you reach your goals tomorrow.

**In this issue you'll find**



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# How inflation impacts your financial future

**Inflation has dominated the headlines lately and many of us have started to feel its effect at the cash register.**

If you've gone grocery shopping, filled your gas tank or purchased materials for a home renovation lately, you've most likely seen and experienced the effects of inflation firsthand. The sharp increases follow last year's unprecedented economic shutdown, supply chain disruptions and higher costs of raw materials.

## INFLATION IS FELT AT THE CASH REGISTER

The following illustration shows the value of **today's average monthly household expenditure on food** purchased from stores, versus 25 years ago and 25 years in the future.

| 25 years ago | Today | In 25 years |
|---|---|---|
| $380 | $628 | $1,030 |

Statistics Canada (2019). Value of goods today based on average expenditure per household on food purchased from stores, expressed as a monthly figure in CAD rounded to the nearest dollar (Table 11-10-0125-01). Value of goods 25 years ago calculated using the Bank of Canada Inflation Calculator. Value of goods in 25 years assumes an inflation rate of 2% compounded annually. For illustrative purposes only.

## How is inflation measured?

**The Consumer Price Index (CPI)** is one of the most widely known economic indicators in Canada. The CPI compares, over time, the cost of a fixed basket of goods and services purchased by consumers – such as food, housing and clothing – providing direct insight into consumer price inflation and overall economic conditions. Essentially, the percentage change in the price of the basket is used as an estimate of the amount of inflation in the economy overall.

## What are the effects of inflation?

The most common effect of inflation is the erosion of purchasing power – in other words, when prices rise, your money buys less.

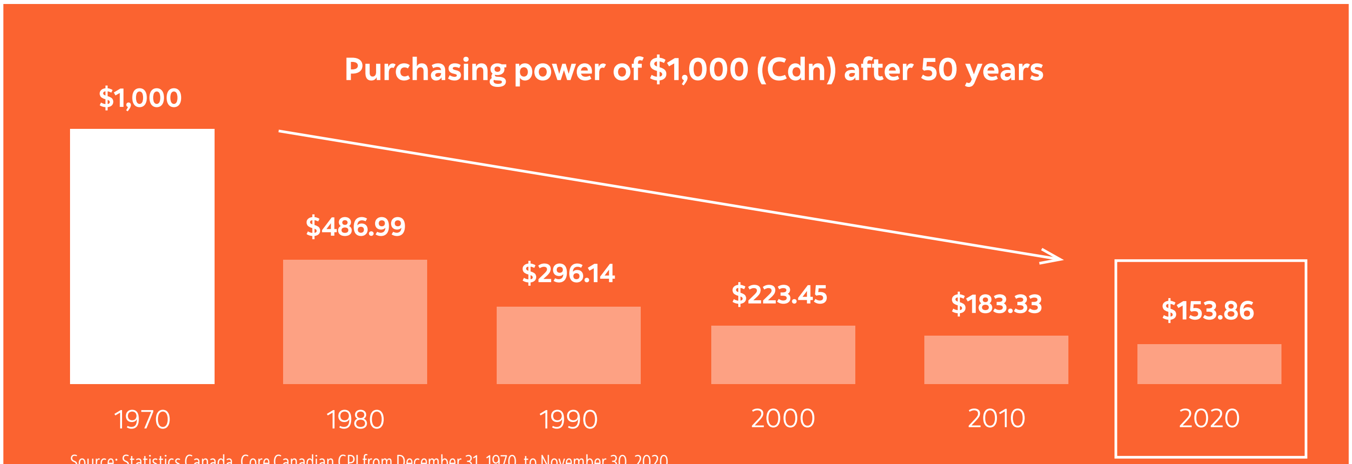
See the simple illustration below, which shows the diminished purchasing power of $1,000 after 50 years – from 1970 to 2020.

### TIP

**Keep in mind the value of goods, not just in today's dollars, but in the future as well**

When saving for a long-term goal, we're planning for the future, while being very much rooted in the present. Often the dollar value assigned to our finish line is the cost of items today – and doesn't account for the impact that inflation can have on the purchasing power of our savings over time.

## THE IMPACT OF INFLATION



Source: Statistics Canada. Core Canadian CPI from December 31, 1970, to November 30, 2020.

## The impact of inflation on long-term savings

The negative impact that inflation has on your savings over time is an ever-present, but often overlooked risk when investing. While the impact of inflation on your investments isn't usually felt in the short term, its impact can slowly erode the purchasing power of your long-term savings. As the price of goods and services increases over time, a higher amount of savings is required to maintain the same level of purchasing power in the future (e.g., retirement).

## What you can do to stay ahead of inflation

Investing in a balanced portfolio, containing a mix of stocks and bonds, has a greater potential to outpace inflation and help build wealth over time. This is due in large part to the strong returns earned by stocks, which have historically beaten inflation by a large margin. **Your portfolio's asset mix of stocks and bonds is a key determinant of meeting your long-term investment goals**. Think of bonds for income potential and as a shock absorber for your portfolio during stock market downturns. By contrast, stocks are the growth engine of your portfolio, with a higher allocation offering greater long-term return potential, but with a corresponding increase in risk.

On the other hand, if your investment portfolio holds a portion of assets in cash for a considerable amount of time, the minimal returns provided by cash may drag down your overall investment portfolio performance (see the portfolio examples to the right).

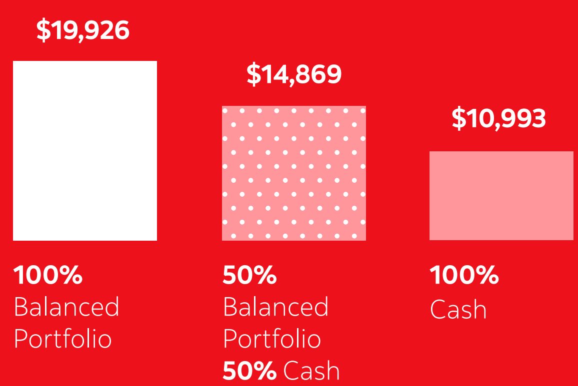
## CASH AND ITS LONG-TERM IMPACT ON YOUR PORTFOLIO[1]

In the following scenario, we invested **$10,000** in three different ways over a 10-year period:

- **fully invested** in a balanced portfolio
- **50%** in a balanced portfolio and **50%** cash
- **100%** in cash

As the graph below shows, if you keep your long-term savings in cash, not only will you be missing out on greater growth potential for your money, but your cash holdings may not even keep pace with inflation, leaving you with a negative real return.

**Based on a $10,000 initial investment over a 10-year period**
(January 2010 to December 2020)




Source: Morningstar

[1] The example is hypothetical and for illustrative purposes only. It is not possible to invest directly in an index. Assumes reinvestment of all income and no transaction costs or taxes. Value of investment calculated using a starting value of $10,000 and annual compounded returns from January 1, 2010 – December 31, 2020. Assumes investment in a balanced portfolio weighted 25% S&P/TSX Composite TR Index, 50% FTSE Canada Universe Bond Index, and 25% MSCI World GR Index. Cash is assumed to have been invested in FTSE Canada 91 Day T-Bill Index.

Commissions, trailing commissions, management fees and expenses may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed or insured by the Canada Deposit Insurance Corporation or any other government deposit insurer, their values change frequently and past performance may not be repeated.

## Minimizing the effects of inflation

No one can completely avoid the effects of inflation. However, a sound investment strategy as part of your financial plan can help you maintain your purchasing power and standard of living in retirement.

Scotiabank offers a wide range of portfolio solutions that are continuously adjusted to control for a variety of risks, including inflation risk.

Talk to your Scotiabank advisor today about building a financial plan that will help you achieve the financial future you've envisioned for the long term.

## ASK THE PORTFOLIO MANAGER

### How do Scotia Portfolio Solutions protect against inflation?

**Judith Chan**
Portfolio Manager
Scotia and Dynamic Portfolio Solutions
Scotiabank

Our multi-asset portfolios invest in market segments and asset classes (e.g., stocks, bonds and cash) that aim to deliver total returns above and beyond the level of inflation over the long term. Inflation is an important consideration when it comes to stock selection by our portfolio managers. We strive to invest in companies that have pricing power for sustainable operating margins, companies that are leaders in their industries, that generate positive cash flow and are delivering a high level of return on invested capital.

By investing in different industries and asset classes, we benefit from the diversification of how they react to changes in inflation rates, which is important from a risk-management standpoint. By investing in a well-diversified portfolio, not only are we helping to protect the purchasing power of the investment, we expect to be compensated with a premium for taking the risk.

# Could you outlive your retirement savings?

## Understanding longevity risk and how to manage it

**Great news:** Thanks to advancements in medicine and health technology, the average life expectancy for Canadians has increased – it's now roughly 80 years for men and 84 for women.[1]

There is, however, a potential downside to a longer life expectancy. With Canadians living longer and spending more years in retirement, their savings must now be able to adequately fund a retirement that could last two decades or more.

### What is longevity risk?

Longevity risk is one of the main concerns facing retirees. It refers to the risk of outliving your savings. It can occur for a number of reasons – you might underestimate how much money you'll need in retirement; your savings might not grow enough over time to fund your desired retirement; or you may live longer than anticipated.

### How you can minimize longevity risk

Longevity issues generally arise as people enter retirement, with a fixed amount of money, but no clear idea of how much is actually needed to fund their desired retirement – for potentially more than two decades. Ultimately, everyone's retirement savings needs will be different as much will depend on individual spending habits, expenses and lifestyle goals.

A good way to help ensure you'll have enough money throughout your retirement is to thoroughly plan. Your planning can start by taking these three items into consideration:

- **All your income sources in retirement**, such as government and/or workplace pensions, registered and non-registered accounts, and Tax-Free Savings Accounts (TFSAs)
- **Your current expenses and estimated future expenses**, to help estimate how much you may spend in retirement, while also identifying debt or expenses that can be reduced or eliminated before you retire
- **Estimated future health care costs**, factoring in government and/or employer benefits that you'll have access to in retirement, and also taking into account any chronic health conditions you suffer from, such as diabetes or hypertension

A Scotiabank advisor can provide you with retirement planning advice and help you build a financial plan that will set you on the path to building the retirement you've envisioned. It all starts with a simple conversation:

- Book an appointment with a Scotiabank advisor today

*or*

- Visit the Scotia Advice+ Centre at **scotiabank.com/retirement** for timely financial articles, tips and tools, like the **Retirement Savings Calculator**

## MANAGING LONGEVITY RISK WITH YOUR LONG-TERM SAVINGS

**Typically, when investors think about risk**, they focus more on the day-to-day fluctuations in the markets and place emphasis on recent activity. In other words, investors tend to give more importance to short-term, rather than long-term performance. Behavioural finance experts call this recency bias.

The downside of letting actual or perceived market risk impact long-term planning, specifically retirement planning, is very real. An overly conservative approach to retirement investing can limit your growth potential, and with that, increase the risk of falling short of your retirement goals or running out of money – especially after factoring in inflation.

**How can you manage longevity risk?**
Diversifying your portfolio to include a balance of conservative and growth-oriented investments has the potential to boost the value of your portfolio over the long run and combat longevity risk.

Keep in mind that any move to increase the return potential of your portfolio comes with added risk, but that risk can be managed with proper planning and the right balance of investments for each stage of your life.

While building an adequate retirement portfolio is job one, a retirement income plan can help create sustainable cash flow throughout your retirement years when your regular paycheque stops. Your retirement income plan and withdrawal rate should take all your retirement resources into account, including government benefits, employer pension plans and your personal savings, including registered investments.

Speak with a Scotiabank advisor to ensure you have a personalized plan and an appropriate mix of investments that can help you to achieve, and maintain, your desired retirement lifestyle.

## Closing the funding gap in retirement

Following are some strategies to consider if you think you may encounter a gap between your retirement savings and your desired retirement lifestyle.

### Increase your current rate of savings

If you have set up regular contributions to go towards your retirement savings through Pre-Authorized Contributions (PACs), consider increasing your contribution amount and/or frequency (e.g., change monthly contributions to bi-weekly). If you don't have a PAC in place, consider setting one up as it's a great way to build your savings easily and automatically. To see how quickly your savings can grow, visit **scotiabank.com/PAC** and try out our interactive PAC video.

### Retire at a later date

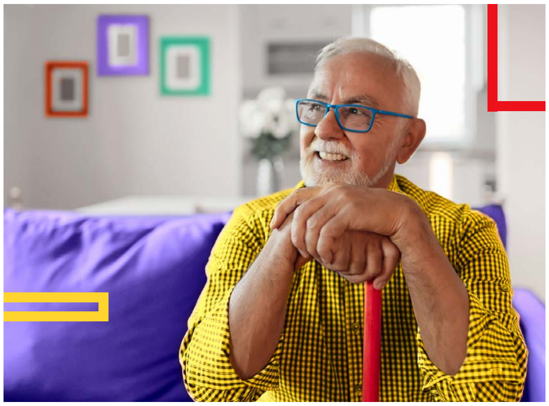
Continuing to work for a few more years may provide you with the funds needed to help you achieve and/or extend the retirement lifestyle you want.

**QUICK FACTS**

Here's when Canadians say they expect to retire from the workforce

| | |
|---|---|
| 23% | Between **65** and **69** |
| 19% | Between **60** and **64** |
| 10% | Between **55** and **59** |

Source: Scotiabank, Scotiabank Investment Poll, 2021.



### Change certain lifestyle assumptions

If you're worried about longevity risk, you could consider making some changes to your retirement lifestyle. Maybe that means decreasing the number or length of trips you take each year, or perhaps downsizing to a smaller residence to reduce your household expenses (e.g., utilities, property tax, insurance).

### Explore part-time work options in retirement

Another strategy for extending your retirement savings might be to take on part-time work. Depending on your specific career, you may be able to continue to work part-time or consult in the same field from which you retired. This income may allow you to draw a smaller amount from your retirement savings, thereby extending the amount of time your savings will last.

### Consider leveraging your home's value

The value of your home has likely increased significantly over the years, which means you could look into a borrowing plan tied to the equity in your home. To learn more about this option and to see if it's the right strategy for your situation, you can speak with a Scotiabank advisor.

Another option may be to consider renting out your basement (if it's finished) to supplement your income, or to rent out your home during the winter months if you escape to a warm destination each year. This is also a good way to ensure you're not leaving your house empty for an extended period of time.

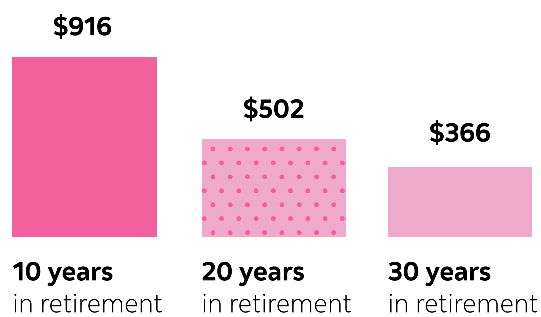
[1] World Population Review, Life Expectancy by Country 2021, https://worldpopulationreview.com/countries/life-expectancy

## HOW LONG WILL $100,000 LAST?

Let's take a look at three scenarios of someone who retires with a $100,000 investment and see how much they can withdraw each month based on a retirement that spans 10, 20 or 30 years. This example assumes the investment will be fully depleted over 10, 20 or 30 years.

As the graph below illustrates, the longer the time in retirement, the less money a retiree will be able to withdraw every month as the savings need to be stretched out over a longer period of time.

**Monthly withdrawal amount for retirement spanning 10, 20 or 30 years**




For illustrative purposes only and not intended to reflect an actual rate of return, future value, or future cash flow of an actual mutual fund or any other investment. The calculation assumes reinvestment of all income and no transaction costs or taxes. The monthly withdrawal amount is adjusted for inflation using an assumed inflation rate of 2.0% and assumes savings are fully depleted over 10, 20, or 30 years starting with a hypothetical investment amount of $100,000. Assumes a hypothetical rate of return of 4%, compounded annually. Amounts are rounded to the nearest dollar.

# When should you review your financial plan?

***Congratulations***, if you're one of the many Canadians who has a financial plan in place! You've taken a decisive step toward creating a financial roadmap that can help guide you toward a more secure future.

While having a financial plan is a great start, it's important to remember that to provide its maximum benefit, your plan needs to be continually updated to reflect the ongoing changes in your life. That includes everything from marriage and the birth of a child to career changes or a new home purchase, just to name a few.

Keep in mind that financial planning is an ongoing process. That's why we often refer to a financial plan as a "living document," something that's continually amended to reflect the changes in your life. For that reason, it's a good idea to keep your plan accessible so that you can easily review it as your financial situation changes.

> **"The only constant in life is change."**
>
> **-Heraclitus, Greek philosopher, 500 BCE**

In the following article, we'll take a look at key life milestones that should trigger a review and possibly an update to your plan. The following article assumes you already have a financial plan in place. However, if you don't have a plan, schedule a meeting with a Scotiabank advisor today to create a plan that will help you achieve your financial goals. For some compelling reasons to establish a financial plan, see *Five benefits of having a financial plan* later in this article.

## OPPORTUNITIES FOR REVIEW: THE TIME IS NOW

So when should you review your financial plan? While a lot depends on your circumstances, it's recommended you review your plan once a year, at a minimum – and maybe more – especially if there have been significant life changes, such as:

- The birth of a child
- New job/career change/promotion/salary increase
- Job loss
- Marriage/Divorce/Separation
- New home purchase
- Death or inheritance
- Disability, illness or a change in health status
- Major move to a new province or country
- Paying off a major debt
- Major asset purchase (car, boat etc.)

**Annual investment portfolio reviews with your advisor also provide an excellent opportunity to discuss and update your financial goals as they relate to your plan.**

## The bigger picture

While the list of key life events outlined above is fairly comprehensive, here's a few more things to consider when reviewing your financial plan.

### Goals

Goals are an essential element of any good financial plan. However, you'll find that your goals will change as you enter different stages in your life. Are all of your goals still relevant to your financial plan? Maybe you can eliminate some goals you've achieved (like paying off your student or personal loan) and add new ones (like saving for a home or your child's education). Reviewing your goals will provide a sense of the progress you're making and perhaps prompt you to reconsider specific goals or new approaches to achieving them.

### Cash flow

It's a good idea to periodically review your cash flow – particularly when you experience a key life event that may impact your income and/or expenses. It may be necessary for you to make adjustments to your financial plan for the short- or long-term to address changes in your cash flow.

### Reconsidering risk

Each key life event we experience will inevitably alter our approach to risk. For example, with the birth of a child, having adequate life insurance to protect your family financially may become a priority. Risk is also a key consideration when it comes to investing. As you approach retirement, you'll probably start reducing your investment risk in order to safeguard your portfolio against market downturns or financial crises.

### Your financial plan review: It all starts with a simple conversation

Whether you need to revise your financial plan or simply want to review certain goals, a Scotiabank advisor will work with you to update your plan to help ensure you're on track to achieve your financial goals. Visit **scotiabank.com/advice plus** for information, tips and tools on financial planning.

## FIVE BENEFITS OF HAVING A FINANCIAL PLAN

1. **Helps you set goals and plan for your future**

   Whatever you want to achieve in life, a financial plan will help you set realistic financial goals and outline a strategy and timeline for achieving them.

2. **Identifies opportunities**

   Whether it's growing your savings, reducing debt, or selecting tax-efficient investments to help you keep more of your money, a financial plan can help you get better financial outcomes.

3. **Helps you navigate your finances with confidence**

   Working with a financial advisor to create a financial plan will help you build up your wealth through better savings approaches, while increasing your financial knowledge, so that you can be confident in the choices you make.

4. **Plan for the unexpected**

   A financial plan can help analyze your current financial situation and put in place appropriate safeguards to handle unexpected life events (e.g., disability or illness, job interruption, loss of life).

5. **Provides peace of mind**

   A financial plan doesn't only give you financial benefits. A major study of Canadians found that those who engage in comprehensive financial planning report higher levels of emotional well-being than those who have engaged in limited planning.[1]

[1] Financial Planning Standards Council, The Value of Financial Planning, 2012.

# Are you maximizing your RESP?

**From saving automatically to taking advantage of government grants, don't leave money on the table**

Whether your child is just learning how to crawl or starting to master their times tables, you're probably thinking a lot about what their future will look like.

Your child will likely be interested in some form of post-secondary education – be it college, university or an apprenticeship. That's why it's essential to start planning for the costs of education now.

But higher education can be expensive. **The average annual cost of post-secondary education in Canada is $19,499.**[1] So, how can you help your child afford to continue their education? Enter RESPs, a smart and ideal way to fund a child's future ambitions.

## LET'S START WITH THE BASICS: WHAT IS AN RESP?

A Registered Education Savings Plan (RESP) is the most common education savings vehicle. It allows parents, grandparents, family and friends to save towards a child's post-secondary education.

Although RESP contributions are not tax deductible, they allow savings to compound and grow tax-efficiently until the beneficiary/ child is ready for college or university.

## FREQUENTLY ASKED QUESTIONS

| | |
|---|---|
| **How much can I contribute to an RESP?** | You can make contributions of up to a lifetime maximum of **$50,000 per beneficiary** (i.e., your child or whoever the RESP is set up for). |
| **What types of RESPs can I chose from?** | There are options:<br>→ A **family plan** to pool contributions for one or more children in the same family until age 31<br>→ An **individual plan** to name one beneficiary without age or relationship restrictions (it can even be yourself) |
| **Are my RESP contributions tax deductible?** | Contributions are **not tax-deductible**, but the investment income earned inside the plan is tax-deferred until you withdraw it.<br>When the funds are taken out of the RESP as an **Education Assistance Payment** (EAP), the investment income and grants are considered taxable income to the beneficiary. Your child, or beneficiary, will need to make sure they include this amount as part of their income in the year it is withdrawn. |
| **How can I make an RESP contribution?** | You can deposit a **lump sum** or arrange to have **Pre-Authorized Contributions** (PAC) taken from your bank account on a regular basis. To see how quickly your savings can grow, visit **scotiabank.com/PAC** and try out our interactive PAC video.<br>Check out the **Scotiabank RESP Reality Check** online tool to see how you can plan out your savings for your child's education. |
| **What if my child decides not to pursue a post-secondary education?** | You have several options:<br>→ You can name **another beneficiary**, if certain conditions are met.<br>→ You can make a **tax-free withdrawal** of your original contributions, but any grants and bonds received must be returned to the government.<br>→ You may be able to **transfer up to $50,000 of the investment income**, tax-free to your Registered Retirement Savings Plan (RRSP) or your spousal RRSP, if you have enough contribution room available. Plus, you can also withdraw the investment income as cash (which would be subject to taxes).[2] |

## MAXIMIZING YOUR RESP'S VALUE WITH FEDERAL GOVERNMENT INCENTIVES[3]

The government partially matches contributions to an RESP in the form of grants, helping to increase education savings faster and more effectively.

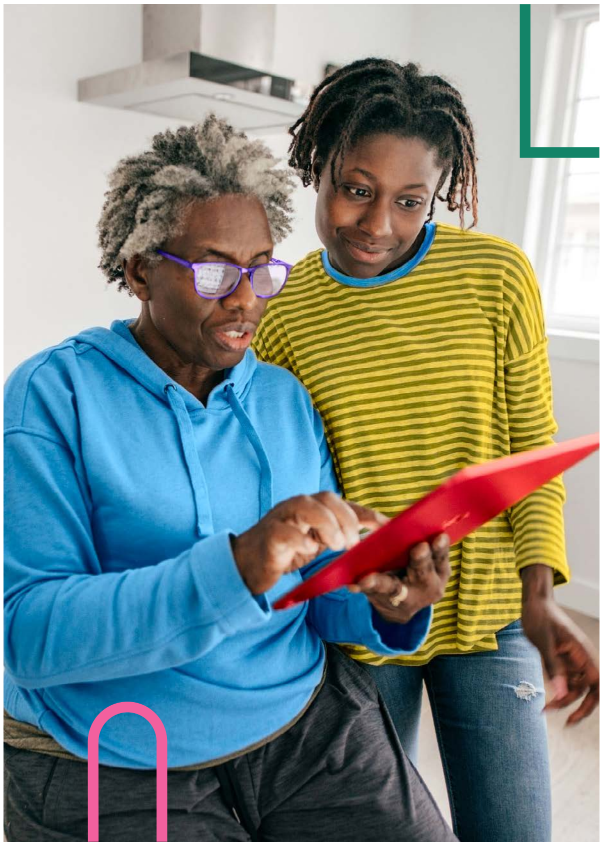
### Canada Education Savings Grant (CESG)

- The Canada Education Savings Grant (CESG) matches **20%** on the first **$2,500** of your eligible contributions each year. So you can receive up to $500 (per year, per beneficiary under 18) to a lifetime maximum of **$7,200**.[4]

- Depending on your net family income, you could also receive an additional CESG, of **10%** or **20%** on the first **$500** contributed each year, up to $100 (per year per beneficiary under 18) towards the maximum lifetime CESG of **$7,200**.[4]

**Let's look at net family income in more detail**

The Additional amount of CESG may be up to:
- $100 if the 2021 adjusted net family income is $49,020 or less ($500 x 20% = $100)
- $50 if the 2021 adjusted net family income is greater than $49,020 and up to $98,040 ($500 x 10% = $50)



### Canada Learning Bond (CLB)

- An eligible child born on or after January 1, 2004 may receive the Canada Learning Bond, which offers a **$500 initial deposit**, then **$100 per year** until the eligible child reaches 15 years of age, to a maximum of $2,000.[5] You do not have to contribute to your RESP to apply for or receive the CLB.

## CONSIDER THESE TWO RESP CONTRIBUTION STRATEGIES

### 1. Annual investment strategy

This is the most common savings strategy which allows parents and family members to save significant funds, while maximizing annual government grants, to help fund post-secondary education.

### 2. Lump-sum investment strategy

For those with the financial means, a one-time maximum contribution of $50,000 per beneficiary is an efficient savings strategy to accumulate as much money as possible for post-secondary education.

| | Annual investment strategy | Lump-sum investment strategy |
|---|---|---|
| **How does it work?** | Contribute $2,500 (or approximately $208 monthly) each year until the beneficiary turns 17, with an additional lump-sum contribution of $7,500 in the final year | Contribute the $50,000 lifetime maximum in year one and remain invested until the beneficiary reaches age 18 |
| **Your total contribution** | $50,000 | $50,000 |
| **Canada Education Savings Grant (CESG) amount** | $7,200 lifetime maximum ($500 per year, per beneficiary under 18) | $500 (as there is only one contribution made in the first year)* |
| **Investment growth** (Assumes a 4% annual rate of return) | $25,200 | $51,804 |
| **Estimated value of RESP when beneficiary turns 18** | **$82,400** *(See illustration on next page)* | **$102,304** *(See illustration on next page)* |
| **What is taxable and to whom?** | Both the CESG ($7,200) and the Investment growth ($25,200) are taxable in the beneficiary's hands upon withdrawal (a total of $32,400) | Both the CESG ($500) and Investment growth ($51,804) are taxable in the beneficiary's hands upon withdrawal (a total of $52,304) |

* Assuming the child is not eligible for the additional amount of CESG.

## ANNUAL vs. LUMP-SUM INVESTMENT STRATEGY

The following graphs compare both strategies based on an assumed 4% annual rate of return


[1] Source: Maclean's magazine (2018). Weighted average of all major expenses for a typical undergrad student living off-campus at a Canadian university.
[2] Some conditions apply. Speak with your financial advisor for more details.
[3] Conditions apply to all government incentives. Please ask your financial advisor for details.
[4] Until December 31 of the year the beneficiary turns 17. Restrictions apply.
[5] The Canada Revenue Agency determines eligibility.

## ANOTHER OPTION TO ASSIST WITH EDUCATION COSTS: TAX-FREE SAVINGS ACCOUNT (TFSA)

If you have concerns that an RESP may not provide enough funds to cover post-secondary costs, another viable option to consider that can effectively complement your RESP is a TFSA.

RESPs and TFSAs are similar as contributions made to either type of account are not tax deductible.

Let's look at some benefits of a TFSA:

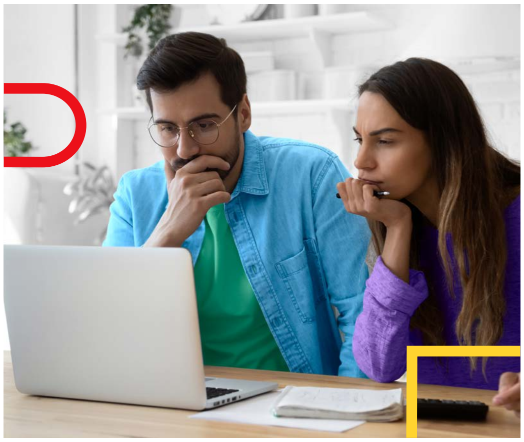
- Income earned within a TFSA is never subject to tax, even when funds are withdrawn
- Funds within a TFSA can be used for any purpose – not just for education
- The cumulative TFSA lifetime contribution limit is $75,500, with a current annual limit of $6,000. The lifetime maximum contribution for an RESP is $50,000 per beneficiary.

A Scotiabank advisor can develop an education savings strategy that works with your financial situation, incorporating applicable government incentives, to help you meet your child's education needs. To learn more or to open an RESP, speak with a Scotiabank advisor today.

# An introduction to mutual funds and ETFs

**Mutual funds and Exchange-traded funds (ETFs) are two of the more popular investment products available to investors.**

It's important to understand their unique characteristics so that you can make an informed decision as to which one – or both – is best suited to your unique investment goals, financial knowledge and the time you're able to commit to building a portfolio.



Both mutual funds and ETFs deliver access to a well-diversified basket of securities from a wide variety of Canadian, U.S. and international stocks and bonds. With mutual funds and ETFs, investors can choose to invest broadly (perhaps in an index fund that matches the TSX Composite Index), or more narrowly (for example, dividend-paying stocks or a particular sector, like energy).

Mutual funds still dominate the investment market in Canada, with roughly more than $1.9 trillion worth of assets[1]. ETFs have become popular with investors with over $313 billion in assets under management as of July 2021 – a nearly 30% increase from the year before.[2]

Let's take a look at some of the key differences between mutual funds and ETFs.

## KEY DIFFERENCES

### Management approach: Active versus Passive

Many traditional mutual funds are **actively managed, meaning seasoned portfolio managers are at the helm picking and choosing the fund's investments**. Their investment knowledge and experience can be an invaluable resource, especially for many investors who simply don't have the time or investment expertise to research, trade and review individual securities on their own.

While mutual funds are generally associated with active management, there are also passively managed mutual funds, known as index funds. Passively managed mutual funds are designed to closely track the performance of a recognized equity or bond index, such as the S&P/TSX Composite Index for Canadian equities or the FTSE Canada Universe Bond Index for Canadian bonds. Unlike actively managed mutual funds, there is no active security selection and the risk and return profile of the funds is specific to that of the index it tracks.

The vast majority of ETFs are also **passively managed** and track an index – unlike mutual funds, which have a portfolio manager overseeing the fund's investments. **ETFs are suitable for investors who have a good knowledge of investing and have the time to dedicate to researching and trading funds**. While actively managed ETFs do exist, and are gaining popularity, this article will primarily focus on index-tracking ETFs.

### Trading

Mutual funds – whether actively managed or index funds – can be bought and sold on any day the market is open and are priced once a day after the market's 4 p.m. Eastern Standard Time (EST) close. In contrast, ETFs trade and are priced throughout the day on stock exchanges – just like stocks – allowing investors to trade throughout the day.

### Investment flexibility

Actively managed mutual funds have a portfolio manager (and usually a team of analysts) that try to outperform their underlying index and can adjust their holdings to respond to market conditions, including adjusting individual securities, sector and geographic allocations, and in some cases, asset mix. **The greater investment flexibility of active management is often considered especially advantageous in volatile or falling markets**.

By contrast, passively managed ETFs have no flexibility to adjust their fund's holdings to reduce risk or increase return potential. If the index they track does well, so does the fund. By the same token, if the index performs poorly, so does the fund.

### Reporting

Most actively managed mutual funds will disclose the top holdings (i.e., the stocks or bonds contained in the fund) on a monthly basis and disclose all holdings on a semi-annual basis. This information is usually found on the mutual fund providers website alongside other important information such as sector or geographic allocations and rates of returns. Passively managed ETFs, on the other hand, typically disclose holdings daily, and investors can view a typical ETF's holdings online any time they want.

### Fees

For the most part, actively managed mutual funds cost more than passively managed ETFs, or index funds, because you pay for the investment-management skill and experience. Due to the passive nature of indexed strategies, the management fees of most ETFs are lower than those of many mutual funds.

### Investing automatically

By investing a fixed-dollar amount on a regular basis, dollar-cost averaging helps control the effect of market volatility by smoothing out the average cost per unit of mutual funds purchased. For example, you may choose to have $100 taken off every paycheque to buy additional shares of a mutual fund. Unfortunately, dollar-cost averaging with ETFs is impractical because there are trading costs associated with buying additional ETF shares, which can quickly add up.

## MUTUAL FUNDS AND ETFs @ A GLANCE

| | Actively Managed Mutual Funds | Conventional ETFs |
|---|---|---|
| **Management approach** | Actively managed by a professional money manager who has the flexibility to change (or alter) the holdings (or composition) of the fund at any time | Passively managed to closely track a recognized index, such as the S&P/TSX Composite Index. It does not have the same flexibility to change the holdings (or composition) of the index as an actively managed mutual fund. |
| **How to Buy** | Usually purchased through a financial institution (such as Scotiabank) or a financial advisor | Purchased through a broker or online trading platforms (such as Scotia iTRADE) |
| **Trading** | Traded and priced once daily, at market close | Traded and priced throughout the day on exchanges (like stocks) |
| **Investment flexibility** | Greater flexibility; free to deviate from the fund's underlying index | Must track the performance of index holdings (like the S&P/TSX Composite Index) |
| **Reporting** | Top holdings disclosed monthly; full holdings semi-annually | Holdings disclosed daily |
| **Fees** | Higher management fees | Lower management fees |
| **Investing automatically** | Better suited to Dollar-Cost Averaging | Not suited for Dollar-Cost Averaging |

## DID YOU KNOW?

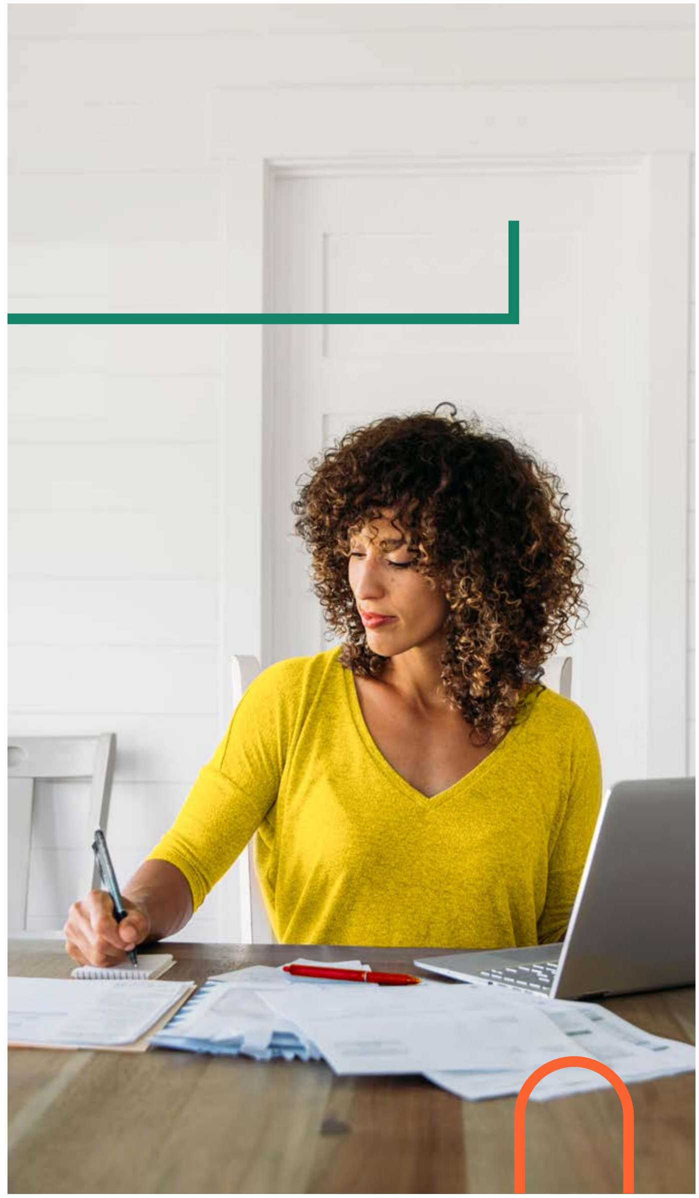
The most frequently held investment products among Canadian investors

| | |
|---|---|
| **89%** | Mutual funds |
| **69%** | Stocks |
| **54%** | Guaranteed Investment Certificates (GICs) |
| **29%** | Exchange-traded Funds (ETFs) |
| **23%** | Bonds |

Source: Ipsos Canadian Financial Monitor (12 months ending August 2021).

To learn more about mutual funds visit the "Learning Centre" on **scotiafunds.com** for helpful videos and information.

Visit **scotiabank.com** to learn about ETFs offered by Scotiabank and visit the "Learning Centre" on **scotiaitrade.com** to learn about investing with ETFs.



1, 2 Source: The Investment Funds Institute of Canada, IFIC Monthly Investment Fund Statistics – July 2021.

Commissions, trailing commissions, management fees and expenses may be associated with mutual fund investments, including ETFs. Please read the prospectus before investing. Mutual funds and ETFs are not guaranteed, their values change frequently and past performance may not be repeated.

# Market insights


## MARKET RECAP

### Supply chain problems hold back the economy while year-to-date equity returns remain strong

While the global economy has experienced solid growth throughout 2021, supply chain disruptions have held back even more growth, and also caused product shortages and rising prices. A shortage of shipping capacity has come from too few shipping containers, port congestion, and a lack of truck drivers, while shipping costs have increased dramatically. Shortages of key materials – such as semiconductors – have made a material impact on a variety of industries, hindering production of cars, smart phones, and appliances. These ongoing supply chain issues are constraining the business of companies in a variety of industries, and have dampened gains of major stock indices in recent months. Some industry experts believe many of these problems will be resolved in 2022, while others think supply chain issues will linger even longer.

## Economic data continue to indicate growing inflation

In both Canada and the U.S., a series of economic reports have shown rising prices for a variety of goods. Much of this is due to the shock to the global economy from the COVID-19 pandemic, and the robust rebound experienced over the past year. Supply chain issues remain in place, as global shipping capacity remains constrained, and shipping costs remain dramatically elevated. While central bankers have repeatedly suggested that this year's inflation is transitory, it remains to be seen how long it will persist. The spike in inflation and possibility of a shift in monetary policy has weighed on fixed-income market returns in 2021, particularly in more interest-rate sensitive government bonds.

## Central bankers are preparing to withdraw stimulus measures

In reaction to growing inflation, and positive signs of an economic recovery, officials from the U.S. Federal Reserve (the Fed) and the Bank of Canada (BoC) have announced a shift towards reduced stimulus. The Fed will start reducing its $120 billion in monthly asset purchases in November, concluding by the middle of 2022. The BoC recently announced the end of its monthly bond buying program. Both the Fed and BoC have promised to keep interest rates at current levels until the economy and employment show evidence of further recovery. Investors are watching central banks closely for signals on the timing of a policy shift, given the implications for both stocks and bonds.

## MARKET PERFORMANCE

| Index | YTD Total Returns in Canadian (CAD) currency as at September 30, 2021 | Q3 Total Returns in Canadian (CAD) currency as at September 30, 2021 |
|---|---|---|
| FTSE Canada Universe Bond Index | -4.0% | -0.5% |
| S&P/TSX Composite Index | 17.5% | 0.2% |
| S&P 500 Index | 15.3% | 2.9% |
| MSCI World Index | 12.8% | 2.4% |
| MSCI Emerging Markets Index | -1.5% | -5.9% |

Source: Morningstar

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