Simple Low Cost Self-Directed Investing

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Many Canadians, young and old, have no idea how to invest making them vulnerable to theft with a smile. Anyone can invest using Exchange Traded Funds. ETFs provide an easy low cost way to own shares in multiple publicly traded companies with a single purchase. ETFs are provided by banks, public companies and private companies in Canada and the USA. ETFs trade in real time on Canadian and US stock exchanges just like stocks.

Unlike most mutual funds, ETFs charge low management fees plus expenses to administer the fund, no up front sales fees and no (hidden backend) trailer/advisor fees. The total of all ETF fees is called the management expense ratio or MER. For passive index ETFs this fee can be less that 0.1% per year. For more specialized ETFs that require more active management the MER can approach 1% per year. These fees compare very favourably with the prohibitive fees of Canadian mutual funds that can cost upwards of 2.5% per year.

To own ETFs you need a brokerage account. Don't let that scare you. Think of it as a savings account that can generate both income and long term capital growth. Brokerage accounts are for buying and holding stocks (shares of public companies also called equities), bonds, cash and ETFs. You might want an account for your 'before tax' Registered Retirement Savings Plan (RRSP), another for a RRIF (so you can start moving money from your RRSP) and another for your 'after tax' Tax Free Savings Account (TFSA). When you reach the limits of these you can open a margin account for which there are no special tax considerations i.e. interest, dividends and capital gains are subject to personal income tax in the year received.

Most experts recommend international diversification. Canada is only 3% of the global investment scene. The US is about 50%. The rest of the developed markets, referred to as EAFE (Europe, Australasia and Far East) make up about 30% and include Australia, Israel, Hong Kong and Singapore. Emerging markets make up about 10% and are considered to have higher growth potential with higher risk. Among them are the BRIC countries (Brazil Russia India China), Mexico, Poland, South Africa, South Korea, Turkey, Indonesia, Malaysia, Thailand, Philippines and Colombia. Finally frontier market countries such as Argentina, Croatia, Slovenia, Pakistan, Sri Lanka and Nigeria make up the remainder of global equity markets.

This article is also about investing for the long term, 10, 20, 30 years or more. Nobody knows what's going to happen to any particular equity or the stock market in the short term. However, slow and steady growth of the overall market over many years is close to a certainty. Index ETFs provide the safety of sector diversification and reduce single company risk. One ETF supplier has a really simple suggested equity portfolio for Canadians: 3% VCN (230 Canadian companies) and 97% VXC (3000 companies outside Canada, half US - unhedged).

The Canadian Dollar is currently quite low and, over the long term, likely to rise relative to the US Dollar and perhaps the Euro. In this situation foreign investments lose part of their value in terms of Canadian Dollars. I have chosen many CAD hedged ETFs to protect against this possible currency loss. This is one of the main benefits of using ETFs because it is not easy for the average investor to manage currency hedging.

For online education click the ETF tab at canadiancouchpotato.com. For information on Canadian ETFs see etfinsight.ca. For information on US ETFs see etfdb.com and zacks.com. Also, each of the 12 Canadian ETF providers (and numerous US providers) has a web site with details on each of their ETFs. NOTE: there are now 243 equity ETFs listed on the Toronto Stock Exchange not including the ones I stay away from (income, bond, commodity, leveraged, inverse). To screen all 500+ Canadian ETFs go to http://www.tmxmoney.com/en/investor_tools/etf_screener.html.

How to Own ETFs:

- Open a self-directed discount brokerage account at your bank or online. Such accounts feature a trade cost of less than $10 each time you buy or sell. As mentioned above you may want several accounts for your RRSP, RRIF, TFSA, etc.
- Deposit as much money as you can as often as you can via cheque or online transfer from your bank. You can also transfer holdings from your current brokerage accounts into these new accounts using forms provided by your new accounts.
- If you already have investment accounts (with advisors) there is a form to have these transferred.
- Buy units in one or more ETFs using the brokerage's online platform, or by phone.
- If you don't need income you can enroll in each ETF's distribution re-investment plan (DRIP), if available. Distributions are then automatically re-invested so cash doesn't sit in the account.

Below are some of my current favourite Canadian ETFs. If you want to see a chart of their current price and annual distributions type the 3-character ETF symbol into google.com/finance. You may have to type TSE: plus the symbol to display the correct symbol. NOTE: this table is somewhat out of date so use it as a guide only.

TSX Symbol	CAD Hedged	Description	Sells Calls to Enhance Income	Annual Distribution	Paid	MER
Canada						
ZEB	not required	6 Canadian Banks - equal weight	no	~ 3.5%	M	0.62%
ZWB	not required	Covered Call version of ZEB above	yes	~ 5.3%	M	0.73%
ZWU	no (33% US)	22 Canadian and US utilities, pipelines & telecom	yes	~ 6.9%	M	0.74%
ZLB	not required	40 low volatility Canadian companies	no	~ 2.1%	Q	0.40%
FXM	not required	30 Canadian value companies	no	~ 2.3%	Q	0.60%
USA						
ZDJ	yes	30 large US companies comprising the Dow Jones Index	no	~ 1.8%	Q	0.26%
ZWA	yes	30 large US companies comprising the Dow Jones Index	yes	~ 4.7%	M	0.73%
ZUD	yes	100 dividend paying US companies	no	~ 3.2%	M	0.34%
ZLU	yes	105 low volatility US companies	no	~ 1.8%	Q	0.34%
ZUE	yes	500 large US companies of the S&P500 index	no	~ 1.8%	Q	0.13%
VSP	yes	500 large US companies of the S&P500 index	no	~ 1.7%	Q	0.13%
ZQQ	yes	100 US companies of the NASDAQ 100 index	no	~ 1.2%	A	0.40%
XSU	yes	2000 small US companies of the Russell 2000 index	no	~1.5%	S	0.13%
ZUH	yes	57 US Health Care companies - equal weight	no	~ 0.3%	A	0.40%
ZUB	yes	14 US Banks - equal weight	no	~1.4%	Q	0.40%
Europe & Developed Markets						
ZEQ	yes	125 high quality European companies	no	~ 2.0%	Q	0.46%
ZWE	yes	90 high dividend European companies	yes	~ 6.8%	M	0.73%
XEH	yes	960 small, medium and large European companies	no	~ 1.7%	S	0.25%
ZDM	yes	442 developed market companies outside North America	no	~ 3.3%	Q	0.29%
VEF	yes	1287 developed market companies outside North America	no	~ 2.2%	Q	0.27%
Emerging Markets						
ZEM	no	340 MSCI Emerging Markets Index companies	no	~ 1.7%	A	0.46%
VEE	no	960 FTSE Emerging Markets All Cap Index companies	no	~ 2.4%	Q	0.29%
HAJ	no	280 dividend paying companies - actively managed	no	~ 2.2%	M	2.16%

NOTE: ZEB is a 'sector' ETF not an 'index' ETF. It holds shares in the big six Canadian banks. It pays about 3.5% per year in monthly distributions. ZWB is the 'covered call' version of ZEB. It pays out a larger monthly distribution at the expense of some of the long-term growth potential. If banks are fully valued and not expected to increase much use ZWB. If the economy is expected to flourish for the next few years then use ZEB. You can sell one and buy the other at any time.

NOTE: Most stocks pay dividends. Most ETFs pay distributions. As a general rule, the higher these payouts are, the slower the long-term growth will be. In other words there is a trade off between growth and income.

NOTE: The covered call ETFs above are designed to provide monthly income with reduced growth.

NOTE: I am avoiding resource stocks as much as possible because they have no price control. That is why I really like ZLB, BMO's low volatility Canadian ETF. It has no oil & gas companies, only pipelines. It has no mining stocks. It has one forestry stock WFT that should benefit from US housing pick up. It has one gold non-mining royalty stock FNV. ZLB has a much better sector balance than the Canadian market. It is light on health so is works well with ZUH. It also has only non-bank financials so you can combine it with the ZEB/ZWB ETFs of 6 Canadian banks. It has pipeline/utility/telecom so don't combine it with ZWU.

Some Observations from a 30-year Investment Amateur

For peace of mind, buy and hold simple low cost 'Index' ETFs for the long term. Avoid bond funds because there is no due date when you can be assured you will get your principal back. Avoid balanced funds and income funds because they usually contain bonds. Avoid commodity funds because of the complexities of the futures contracts they employ (e.g. time decay, futures roll). Unless you are an expert and a gambler avoid inverse (bear), double or triple ETFs.

One final word: unless you know exactly what you are getting and all the fees being charged, don't buy mutual funds, especially if an advisor, **including your bank's**, is recommending them. See paragraph 2. Some ETFs have an 'advisor class' usually with a .A after the symbol. This means your advisor has their hand in your pocket for as long as you own the ETF thus your returns will be significantly less than the non-advisor class.

The ETFs mentioned in this article are investment ideas only, not recommendations, not investment advice.