## RJL PCS: INSIGHTS & STRATEGIES

June 3, 2024

**RJL Investment Strategy (Canada)** | RJLInvestment.StrategyCanada@raymondjames.ca
**Neil Linsdell, CFA, Head of Investment Strategy** | 438.843.0150 | Neil.Linsdell@raymondjames.ca
**Eve Zhou, CFA, Multi-Asset Analyst** | 647.577.8766 | eve.zhou@raymondjames.ca
**Larbi Moumni, Head of Portfolio Advisory** | 416.777.6422 | Larbi.Moumni@raymondjames.ca
**Luke Kahnert, Mutual Fund & ETF Specialist** | 416.777.7168 | Luke.Kahnert@raymondjames.ca
**Charlotte Jakubowicz, Fixed Income and Currencies** | 416.777.6411 | charlotte.jakubowicz@raymondjames.ca

# June 2024 Insights & Strategies: Connecting the Dots on the Productivity Problem

***Neil Linsdell, CFA - Head of Investment Strategy; Eve Zhou, CFA - Multi-Asset Analyst***

Canada is in the midst of a productivity problem that even the Bank of Canada's senior deputy governor labeled an "emergency." Recently, there has been a surge in headlines featuring the term "productivity," capturing people's attention, but what does that really mean, and what are the impacts to the financial markets and even the standard of living for Canadians?

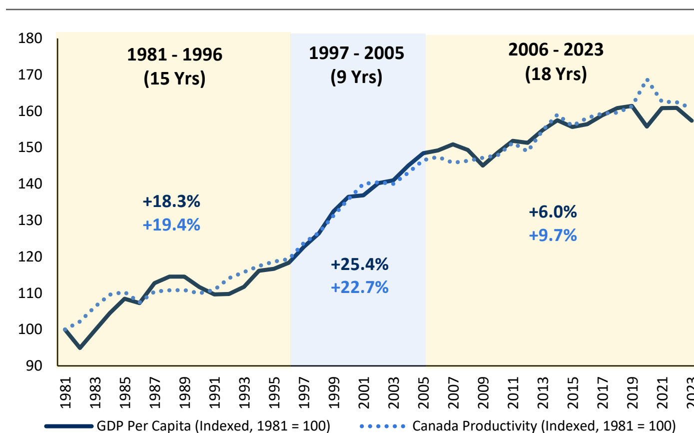
### Productivity: The Main Driver of Living Standards and Long-Term Business Profit Growth

To better understand the significance and critical impact of productivity on an economy, let's start with something more familiar: GDP, or Gross Domestic Product. GDP represents the total value of all goods and services produced within a country's borders. When divided by the country's population, it gives us "GDP per capita" which is also commonly used as a proxy for the standard of living within a country. While it may not be completely fair to directly compare GDP per capita between countries in all cases due to varying costs of living, we can make adjustments for purchasing power, and it can be applicable in measuring the trending of standard of living within a country over time.

Breaking down GDP per capita reveals three main factors: (1) Productivity, (2) Average number of hours worked per worker, and (3) Employment-to-population ratio. By examining the long-term trend of GDP per capita alongside productivity, we find they generally move in tandem (Chart 1). Moreover, regardless of the pace of GDP per capita growth and the macroeconomic backdrop, productivity remains the primary influencing factor, as seen in the breakdown (Chart 2), with the other factors being more consistent. Hence, without necessarily delving into the specifics of the productivity calculation, we understand its critical role in the economic framework. Productivity drives living standards, which is why the Bank of Canada (BoC) has shown significant concern about its decline in recent years.

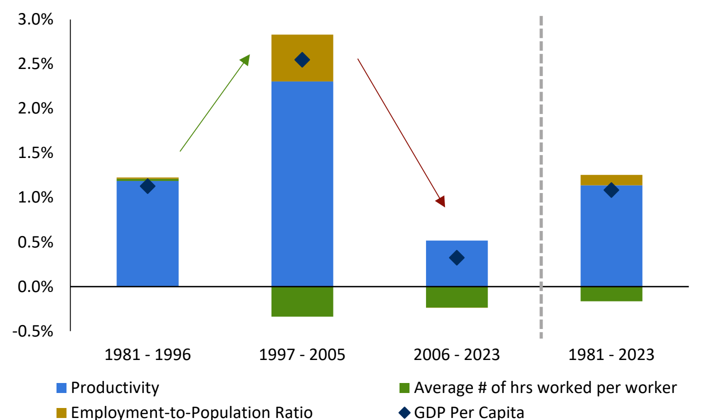
Among the three factors contributing to GDP per capita, the "average number of hours worked per worker" has had a small negative impact, reflecting its relative stability but gradual decrease over time. The "employment-to-population ratio" has made a positive contribution, particularly from 1997 to 2005, due to an increase in working-age people and job creation in Canada. However, this contribution is marginal compared to that of productivity. The key factor is increasing output per hour worked, which is what productivity measures.

**Chart 1 - Canada GDP Per Capita And Productivity Since 1981**




Source: Statistics Canada, Raymond James Ltd.; Data as of December 31, 2023. Time intervals defined by the rate of growth.

**Chart 2 - Factors Contributing to GDP Per Capita Growth (Annualized)**



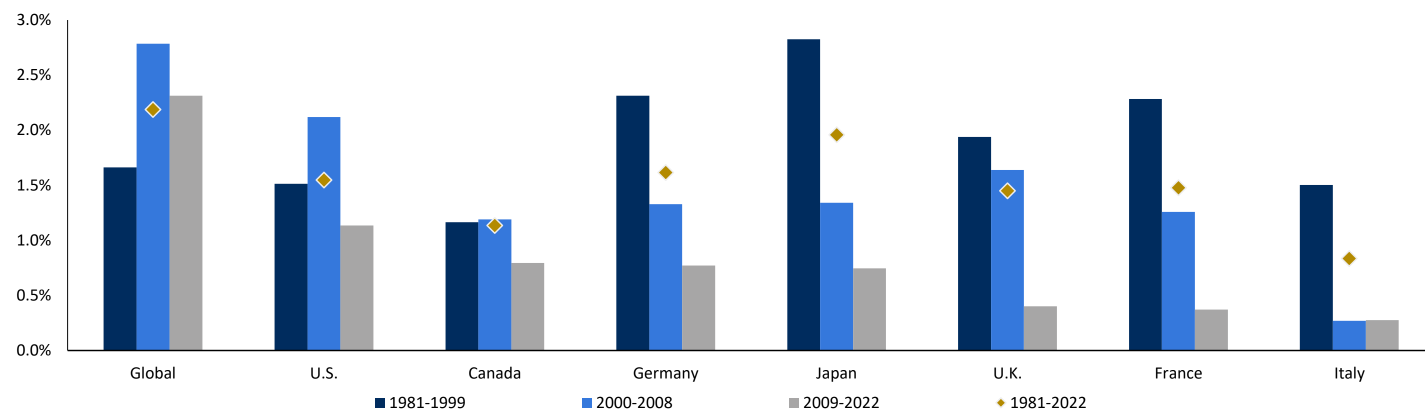

Source: Statistics Canada, Raymond James Ltd.; Data as of December 31, 2023. Time intervals defined by the rate of growth.

This also explains why a population boom fueled by increased immigration since 2021 doesn't necessarily enhance, and may even hinder, living standards. Consequently, the government intends to start curbing immigration in 2025. There are only so many new job openings available to absorb additional labour, and without a significant increase in output per worker, GDP per capita cannot rise substantially. Similarly, in addressing the inflation issue, productivity is a way to shield the economy from high inflation. Less productive employers are more impacted by labour costs that must get passed on to their customers. In contrast, more productive companies tend to have better control on costs and can tend to pay better wages. Therefore, the primary focus now is on boosting productivity, as emphasized by the BoC's senior deputy governor Carolyn Rogers in her March 26 speech[1], describing the situation as an "emergency."

Productivity and labour force growth are both important drivers of real GDP (GDP beyond the rate of inflation). We must also remember that, in the long term, GDP growth determines the underlying potential for businesses operating in a country. Any impediment to growth, such as lagging productivity, also hinders business growth and profit, which in turn affects stock market valuations of public companies and the value of investment portfolios.

Canada's position in productivity growth among the G7 nations highlights the pressing need for improvement (Chart 3). Over the past 42 years, Canada has fallen behind all other G7 countries in annualized productivity growth over that entire period, with the exception of Italy. While it's understandable that emerging countries would experience higher growth rates compared to developed countries, as evidenced by the higher global productivity growth compared to the G7's, Canada's productivity growth has remained relatively stagnant, hovering at the lower end of the G7 spectrum from 1981 to 2008. Meanwhile, Japan and countries in Europe saw significant growth before 2000, and the U.S. saw a resurgence in productivity growth since late 1990s until 2008, driven by investment and technology diffusion. Since the post-global financial crisis up to 2022, Canada's productivity growth has been on par with Germany and Japan, outperforming the U.K., France, and Italy, but still significantly trailing behind the U.S.

**Chart 3 - Productivity Growth of G7 Countries Across Various Time Periods (Annualized, Adjusted for Purchasing Power Parities)**




Source: The Conference Board, Total Economy Database - Output, Labor and Labor Productivity. Raymond James Ltd.; Data as of year end 2022.

### Investment: The Key to Boosting Productivity

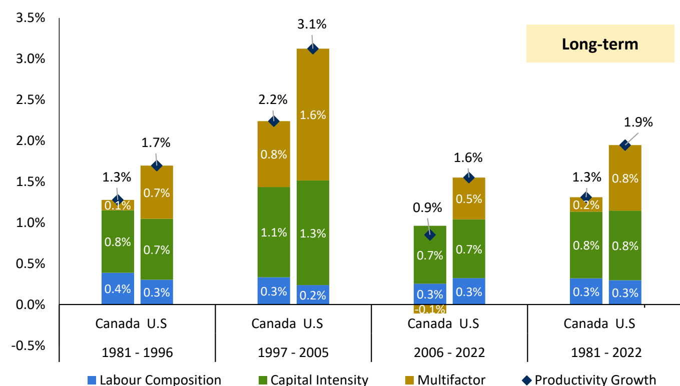
So, what are the reasons behind Canada's lagging productivity? Productivity measures the amount of output produced per hour worked, calculated as GDP divided by the total hours worked in an economy. To better understand the key drivers, we can break down productivity growth into the following three factors:

1. **Labour Composition**: This reflects the effects on productivity growth from skill upgrading, as measured by increases in the experience and education levels of the workforce.
2. **Capital Intensity**: This reflects the effects of capital investment on productivity growth, indicating how much more productive workers are due to better tools, machinery, and infrastructure.
3. **Multifactor Productivity (MFP)**: This captures the effects of technological advances, efficiency improvements, and other factors not accounted for by labour composition and capital intensity, such as a favourable macroeconomic environment.

Examining the breakdown of productivity growth factors in Canada and the U.S., we find that the contribution from labour composition remains stable at around 0.3 per cent in both countries, and is generally much less significant than the other two factors (Chart 4). The recent slowdown

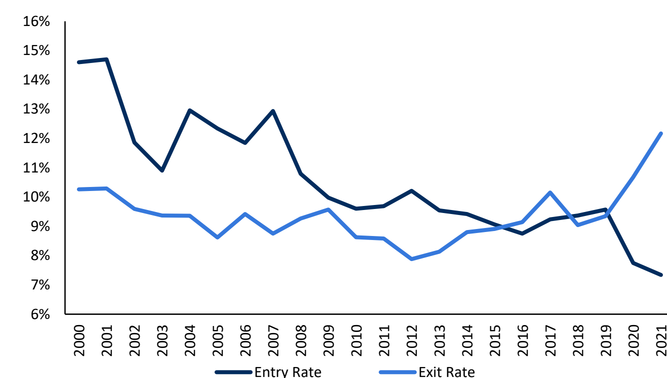
in productivity growth (2006–2022) is attributed more to a substantial decline in MFP growth and lower capital intensity growth compared to the period from 1997 to 2005, characterized by a surge in investment in Information and Communications Technologies (ICT). It's worth noting that business investment tends to enhance productivity through both capital intensity and MFP productivity channels. For instance, ICT investment can boost capital stock per worker if the number of workers increases at a slower rate, as well as, improve efficiency. However, determining the specific contributions of different types of business investments to each of these channels is nearly impossible. Another finding is that the productivity growth gap between Canada and the U.S. is primarily attributed to MFP, indicating a relative lack of business investments in Canada.

**Chart 4 - Breakdown of Productivity Growth (Annualized)**




Source: Statistics Canada. U.S. Bureau of Labor Statistics, Raymond James Ltd.; Data as of December 31, 2022. Time intervals defined by the rate of growth.

**Chart 5 - Lower Entry Rate and Higher Exit Rate in Canada**




Source: Statistics Canada, National Accounts Longitudinal Microdata File database, Raymond James Ltd.; Entry and exit rates are industry-weighted averages based on employment; Data as of December 31, 2021.

### Limited Competition: The Biggest Concern

The primary drag on Canada's productivity growth is the weak record of business investments, with its root cause—low competition—being the biggest concern. According to the report published by Statistics Canada this February[2], a decline in competition leads to a decline in investment, while competition promotes investment among firms. In her March 26 speech, the BoC's senior deputy governor Carolyn Rogers also highlighted that "businesses become more productive when they're exposed to competition. Competition drives companies to become more productive by innovating and finding ways to be more efficient[1]."

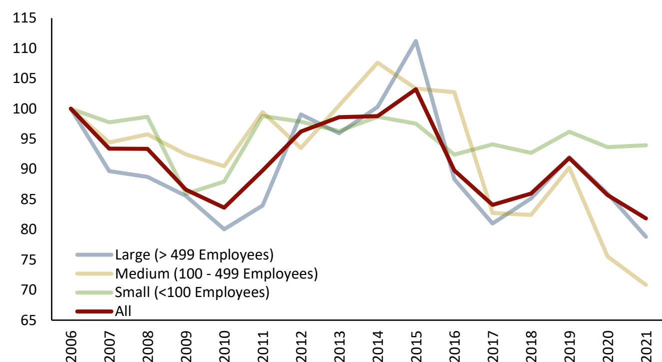
Entry rates and exit rates (of businesses in the country) serve as indicators of competition. In Canada, high entry rates generally signify intense competition, which in turn stimulates investment. However, the entry rate has plummeted from 12.9 per cent after 2006 to only 7.3 per cent post-COVID (Chart 5). Similarly, elevated exit rates usually suggest declining investment opportunities due to weak demand or high market concentration, and firms in industries with high exit rates have less incentive to invest. The exit rate reached a new peak in 2021 at 12.2 per cent. The lower entry rate and higher exit rate suggest diminishing competition in Canada, partially explaining the significant slowdown in productivity since around 2006.

The limited levels of competition in many sectors in Canada are the result of relatively high entry barriers, directly or indirectly erected by the government. According to the OECD[3], Canada's Foreign Direct Investment (FDI) restrictiveness is significantly higher than that of the other G7 countries, ranking 18th out of 80 countries in 2020 (the U.S. ranked 33rd, Italy 48th, Japan 49th, France 53rd, the U.K. 56th, and Germany 67th). Barriers to entry for foreign businesses, state-owned monopolies, and explicit regulations limiting competition collectively protect over 30 percent of the economy, by conservative estimates[4]. Additionally, Canada's Red Tape Report[5] highlights that both the cost of red tape and the cost of necessary regulations increase substantially as company size decreases, as does the annual time spent on regulation per employee. This extra time and resource expenditure places a heavy burden on entrepreneurs, significantly impacting their MFP due to reduced efficiency. Such an environment is unfavourable for promoting entrepreneurship. Since 2000, following a brief period of acceleration from 1997 to 1999, the growth in self-employment has lagged behind both private and public sector employment.

The decline in investment per worker by firm size further demonstrates that a lack of competitive pressure reduces the need for established firms to adopt new methods and technologies. Investment per worker in large and medium firms dropped by 21 per cent and 29 per cent, respectively, from 2006 to 2021, while small firms saw a relatively stable trend but still decreased by 6 percent (Chart 6). The decrease in investment per worker is disproportionately more significant for large and medium-sized firms (Chart 7). Beyond limited competition, two other key factors contribute to this trend. First, the investment per worker in large firms was impacted by the oil and gas price collapse in 2014, as a substantial share of these

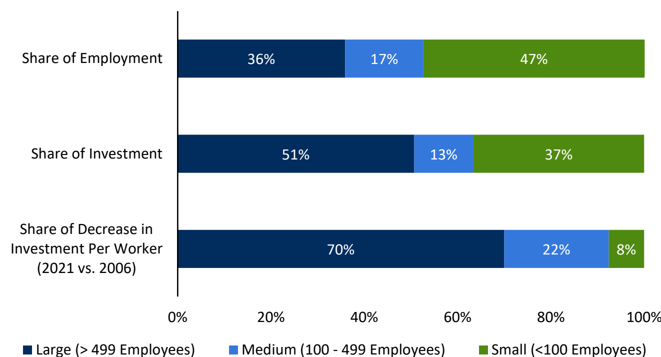
firms are foreign-controlled within the oil and gas sector. Second, there has been a shift from tangible to intangible investments, which is more pronounced among large and medium-sized firms. The investments in intangibles are harder to capture using existing measurement methods. Nonetheless, the decline in investment per worker persists even after excluding these factors. As Carolyn Rogers mentioned, Canada lags behind its global competitors in investment in machinery, equipment, and, importantly, intellectual property[1].

**Chart 6 - Investment Per Worker by Firm Size (Indexed, 2006=100)**




Source: Statistics Canada, National Accounts Longitudinal Microdata File database, Raymond James Ltd.; Data as of December 31, 2021.

**Chart 7 - Contribution to the Decline in Investment by Firm Size**




Source: Statistics Canada, National Accounts Longitudinal Microdata File database, Raymond James Ltd.; Data as of December 31, 2021.

Interestingly, unlike the long-term historical trend where corporate earnings growth and productivity growth are relatively aligned, there has been a noticeable divergence between their growth rates over the past two decades, on a global scale. In Canada, the annualized earnings per share (EPS) growth for large and medium-cap public companies has been five to six per cent, while small-cap EPS grew at three per cent, but productivity growth was below one per cent. This gap is likely due to several factors: the significant increase in global integration, which has substantially lowered input costs for some businesses; a robust labour market fueled by immigrants, which has restrained wage growth; and a low interest rate environment, which has reduced financing costs. Additionally, limited competition has given existing players in many industries higher pricing power, thereby boosting their margins. However, with the world becoming more fragmented and the likelihood of a return to ultra-low interest rates diminishing, we anticipate that most of these trends are nearing their peak. In the long term, GDP growth, supported by productivity and labour force expansion as previously discussed, will be the primary determinant of businesses' underlying profitability in Canada.

## Next Steps

On a positive note, policymakers in this country seem to be well aware of the significance of productivity growth. They understand that excessive protectionism can dampen business investment motivation, and policy uncertainties pose challenges to companies. Despite the proposed capital gains tax hike in the 2024 budget possibly discouraging entrepreneurship in Canada, there have been efforts from various levels of government to encourage Crown corporations, such as the Business Development Bank of Canada (BDC) to finance small and medium-sized businesses to increase their risk appetite, thus facilitating more capital flow to Canadian companies. Additionally, the Competition Bureau of Canada has advocated for greater competition in several sectors, including telecommunications, grocery, and financial services.

Looking ahead, given our anticipation that corporate earnings growth gradually realigns with productivity growth in the future, we maintain a long-term bullish outlook on North American sectors central to ongoing major trends, such as clean energy transformation/electrification, artificial intelligence, and reshoring. These areas are likely to face intense competition and consistently attract increased investments from both the government and private sectors.

From an investment perspective, we find it useful to consider what region, country, or industry might be well positioned for productivity growth in order to achieve above-average returns. This includes having policymakers maintain and support an environment conducive to competition and entrepreneurship. For now, the U.S. seems to be the leader within this context, although we remain optimistic that Canadian governments and individuals have the opportunity to regain momentum.

[1]Carolyn Rogers (2024), Time to break the glass: Fixing Canada's productivity problem, Bank of Canada, https://www.bankofcanada.ca/2024/03/time-to-break-the-glass-fixing-canadas-productivity-problem/

[2]Wulong Gu (2024), Investment Slowdown in Canada After the Mid-2000s: The Role of Competition and Intangibles, Statistics Canada, https://www150.statcan.gc.ca/n1/pub/11f0019m/11f0019m2024001-eng.htm

[3]OCED (2023), FDI restrictiveness, OCED Data, https://data.oecd.org/fdi/fdi-restrictiveness.htm

[4]Vincent Geloso (2020), Barriers to Entry and Productivity Growth, Fraser Institute, https://www.fraserinstitute.org/sites/default/files/barriers-to-entry-and-productivity-growth-4day-week-essay.pdf

[5]Marvin Cruz, Keyli Kosiorek, Laura Jones, and Taylor Matchett (2021), Canada's Red Tape Report, Sixth Edition, Canadian Federation of Independent Business, https://www.cfib-fcei.ca/en/research-economic-analysis/canadas-red-tape-report

## Diversifying Away from Home Country Bias

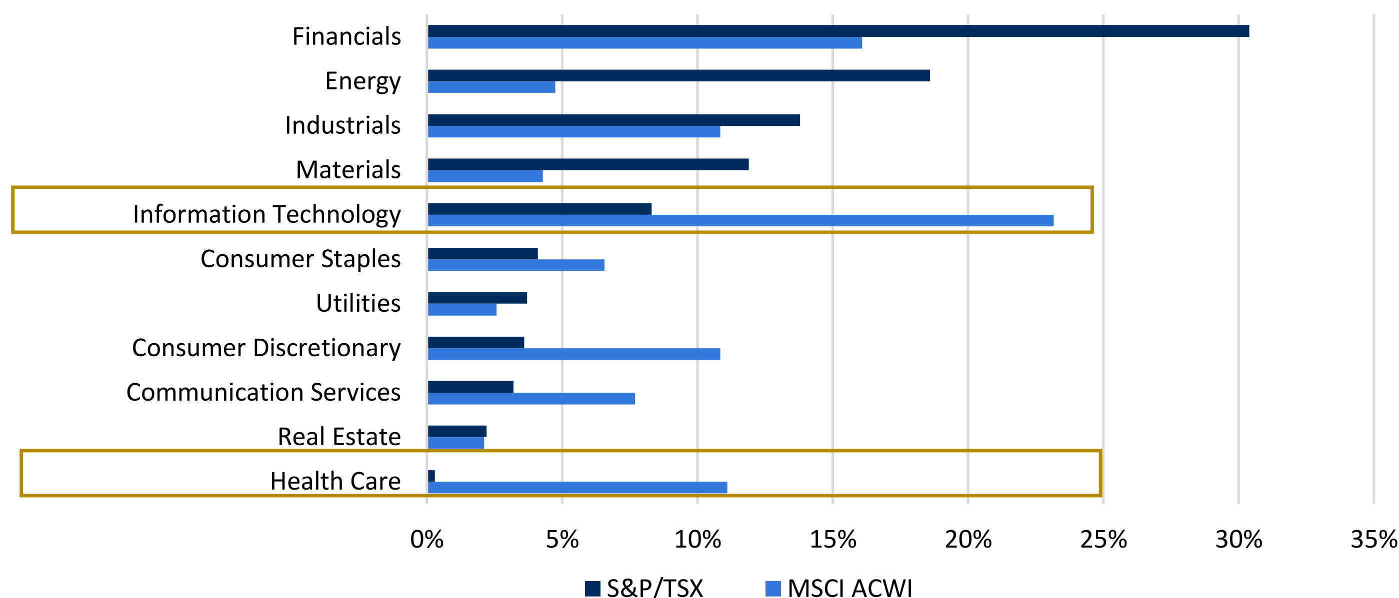
***Larbi Moumni, CFA - VP, Head of Portfolio Advisory***

Home country bias refers to an investor's tendency to allocate a substantial proportion of their investments to domestic stocks and bonds, while underrepresenting or ignoring international investments. While familiar products and services from local companies feel safer, this bias can limit portfolio diversification and expose investors to unnecessary systemic risks. In fact, the average Canadian allocates about 52 per cent of their portfolio to local securities, despite Canada representing only around 2.7 per cent of the MSCI All Country World Index (AWCI). To mitigate this bias, Canadian investors should consider diversifying their equity portfolios through various avenues such as Non-Canadian Canadians (NCCs), U.S. stocks, Canadian Depositary Receipts (CDRs), or American Depositary Receipts (ADRs).

### The Benefits of Diversifying Internationally

Canadian investors have access to many world-class companies, especially in the resource (energy/materials) and financials sectors, which make up over 60 per cent of the S&P/TSX Composite index (S&P/TSX). However, investing outside Canada provides exposure to sectors and companies not well-represented in the Canadian market. For example, information technology and health care sectors make up only 8.3 per cent and 0.3 per cent, respectively, of the S&P/TSX. In contrast, these sectors comprise 23.2 per cent and 11.1 per cent, respectively, of the MSCI AWCI. Diversifying internationally can balance a portfolio and reduce systemic risks tied to the Canadian economy.

**Chart 8 - S&P/TSX vs. Global Sector Weights**




Source: Index data as of April 30, 2024.

### Non-Canadian Canadians (NCCs)

NCCs are Canadian companies that generate a significant portion of their revenue from non-Canadian jurisdictions. These companies, such as Constellation Software (CSU-CA), Brookfield (BN-CA), and Waste Connections (WCN-CA), allow investors to gain exposure to foreign markets without leaving the S&P/TSX. This approach effectively diversifies the end market of the stocks held in a Canadian portfolio without having to exchange Canadian dollars (CAD) for U.S. dollars (USD).

Investing in NCCs provides several advantages:

- Indirect access to international markets
- No need to convert CAD, minimizing foreign exchange costs
- Potential for growth in larger markets outside Canada

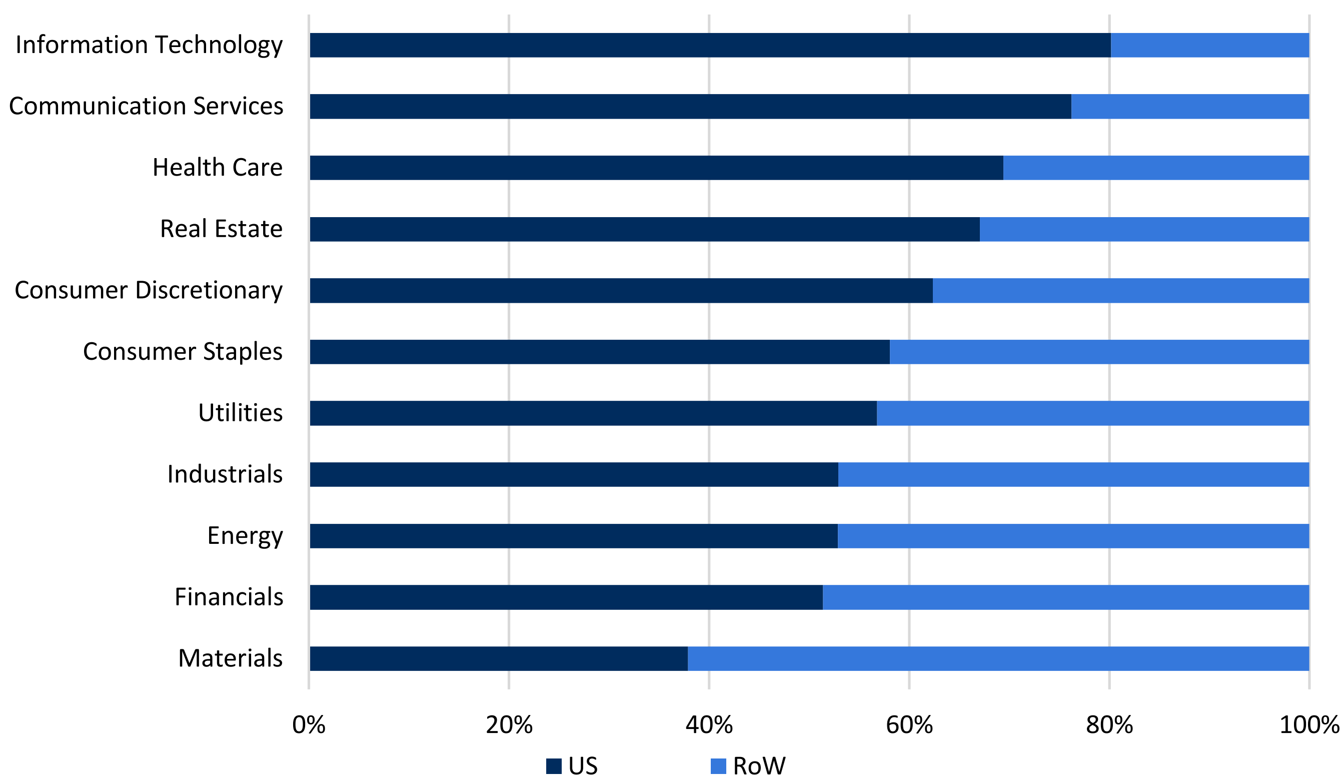
### U.S. Stocks

The U.S. economy is the largest and most diversified globally. U.S. companies comprise over two-thirds of the MSCI AWCI, and more than two thirds of the information technology and communication services sectors. Investing in U.S. stocks gives Canadian investors access to such growth sectors where U.S. companies dominate. Even though foreign exchange is involved, many Canadian investors are comfortable trading in USD with minimal costs via their investment firm. Additionally, investing in U.S. stocks offers tax advantages compared to other jurisdictions.

Advantages of U.S. stocks for diversification:

- Broad access to fast growing companies
- Simplicity associated with buying and selling USD
- Favourable tax treatment related to dividend income from U.S. stocks held in RRSPs and RRIFs due to the tax treaty between Canada and the U.S.

**Chart 9 - U.S. Share of Global Sector**




Source: FactSet; iShares MSCI ACWI ETF data as of May 14, 2024.

### Canadian Depositary Receipts (CDRs)

Investors looking for exposure to U.S. stocks, but not wanting to exchange their CAD may be interested in CDRs. Introduced in 2021, CDRs are modeled after ADRs but allow Canadian investors to buy shares of U.S.-listed companies in CAD directly on a Canadian stock exchange. CDRs offer a notional currency hedge, reducing currency risk and foreign exchange costs. They provide affordable access to high-priced stocks through fractional ownership. The current CDR lineup includes over 50 blue-chip U.S. companies, offering Canadian investors a diverse range of options to reduce home country bias. Below is a table of select high-priced U.S. stocks and their equivalent CDRs.

Key features of CDRs:

- Trade on Canadian stock exchange in CAD.
- Reduced currency risk through currency hedge.
- Lower price points making high-priced U.S. stocks accessible.

**Table 1 - List of High-Priced U.S. Stocks And Their Equivalent CDR**

| Company Name | US Ticker | CDR Ticker | Price per US share (USD) | Price Per CDR (CAD) | CDR Ratio |
|---|---|---|---|---|---|
| Broadcom Inc. | AVGO-US | AVGO-CA | 1412.45 | 34.05 | 0.018 |
| ServiceNow, Inc. | NOW-US | NOWS-CA | 728.86 | 19.48 | 0.020 |
| BlackRock, Inc. | BLK-US | BLK-CA | 771.41 | 20.71 | 0.020 |
| Super Micro Computer, Inc. | SMCI-US | SMCI-CA | 874.72 | 29.97 | 0.025 |
| Thermo Fisher Scientific Inc. | TMO-US | TMO-CA | 572.57 | 21.5 | 0.028 |
| Eli Lilly and Company | LLY-US | LLY-CA | 807.86 | 30.37 | 0.028 |
| Netflix, Inc. | NFLX-US | NFLX-CA | 649 | 25.64 | 0.029 |
| Adobe Inc. | ADBE-US | ADBE-CA | 478.43 | 19.26 | 0.030 |
| lululemon athletica inc. | LULU-US | LULU-CA | 295.25 | 13.48 | 0.033 |
| Costco Wholesale Corporation | COST-US | COST-CA | 813.17 | 38.01 | 0.034 |

Source: FactSet; Data as of May 29, 2024. Ranked by CDR ratio. Each CDR is economically equivalent to owning a number of shares of a global company's stock. The specific number of shares that each CDR represents is called the "CDR Ratio."

### American Depositary Receipts (ADRs)

ADRs are a unique feature of the U.S. stock market, allowing Canadian investors to gain geographical diversity by investing in multinational companies listed on U.S. exchanges. ADRs trade in USD on the NYSE or NASDAQ and provide access to various non-resource companies. The table below ranks the top ten non-resource ADRs by market cap.

Benefits of ADRs:

- Diversification into foreign markets
- Direct exposure to global companies
- Simplified trading process on U.S. exchanges

**Table 2 - 10 Largest ADRs by Market Cap**

| Name | Ticker | Sector | Market Cap (USD blns) | Country |
|---|---|---|---|---|
| Taiwan Semiconductor Manufacturing | TSM-US | Information Technology | 697,536 | Taiwan |
| Novo Nordisk | NVO-US | Health Care | 452,485 | Denmark |
| ASML Holding | ASML-US | Information Technology | 389,337 | Netherlands |
| Toyota Motor | TM-US | Consumer Discretionary | 335,797 | Japan |
| Astrazeneca | AZN-US | Health Care | 238,252 | United Kingdom |
| SAP | SAP-US | Information Technology | 236,755 | Germany |
| Novartis | NVS-US | Health Care | 219,222 | Switzerland |
| China Mobile | CHL-US | Communication Services | 208,074 | Hong Kong |
| PDD Holdings | PDD-US | Consumer Discretionary | 207,927 | Ireland |
| Alibaba Group | BABA-US | Consumer Discretionary | 197,034 | China |

Source: FactSet; Data as of May 29, 2024.

### Conclusion

Canadian investors can significantly improve their portfolio diversification by leveraging NCCs, U.S. stocks, CDRs, or ADRs. Each option offers unique benefits and collectively provides a comprehensive strategy to reduce home country bias. By diversifying internationally, Canadian investors can access a broader array of growth opportunities and mitigate risks associated with an over-concentrated domestic portfolio. For more information and personalized advice, investors should consult their Raymond James financial advisor.

## Target Maturity Bond ETFs

***Luke Kahnert, MBA, CIM - Mutual Fund & ETF Specialist***

As of the end of April, there have been 25 unique target date maturity bond ETFs (TMB ETFs) launched in 2024 — representing a significant portion of overall ETF launches this year. Despite the recent surge in launches, TMB ETFs are not new to the Canadian marketplace and have been around for quite some time with the first TMB ETF, **RQA (RBC Target 2013 Corporate Bond Index ETF),** launched on September 15th, 2011. Similar to other fixed income strategies, these ETFs have benefited from stronger investor interest due to the current interest rate environment.

### The Potential Benefits/Uses of TMB ETFs

TMB ETFs are a unique innovation in the ETF market as they mature like a bond, they trade like a stock on the exchange, and they are well-diversified across many bond issues within a single ETF ticker. Unlike traditional bond index ETFs, which have no termination date and whose duration remains constant, the durations for TMB ETFs decrease over time as they approach their designated maturity. For investors, these types of ETFs may be useful when building bond ladders, adjusting yield curve positions or when matching liabilities in a portfolio with future investor cash flow needs.

### TMB ETFs in Canada

There are two main TMB ETF structures available in the Canadian marketplace — **target maturity government bond ETFs** and **target maturity corporate bond ETFs.** The first structure provides a basket of *government/agency bonds* with effective maturities in the same calendar year whereas the latter will invest in a basket of *corporate bonds* with effective maturities in the same calendar year. In the Canadian marketplace, TMB ETFs are offered at RBC iShares, TD Asset Management and Guardian Capital. When comparing strategies across these ETF issuers, there are various degrees of active management that make each ETF issuer unique in their approach. A full list of government and corporate TMB ETFs can be found in the table below.

**Table 3 - TMB ETFs**

| | Canadian Corporate TMB ETF Tickers | | | | | | | Canadian Government TMB ETF Tickers | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Maturity Year** | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 |
| **RBC iShares** | RQL | RQN | RQO | RQP | RQQ | RQR | RQS | RGQL | RGQN | RGQO | RGQP | RGQQ | RGQR | RGQS |
| **TD AM** | - | TBCE | TBCF | TBCG | - | - | - | - | - | - | - | - | - | - |
| **Guardian Capital** | GBFA | GBFB | GBFC | GBFD | - | - | - | - | - | - | - | - | - | - |

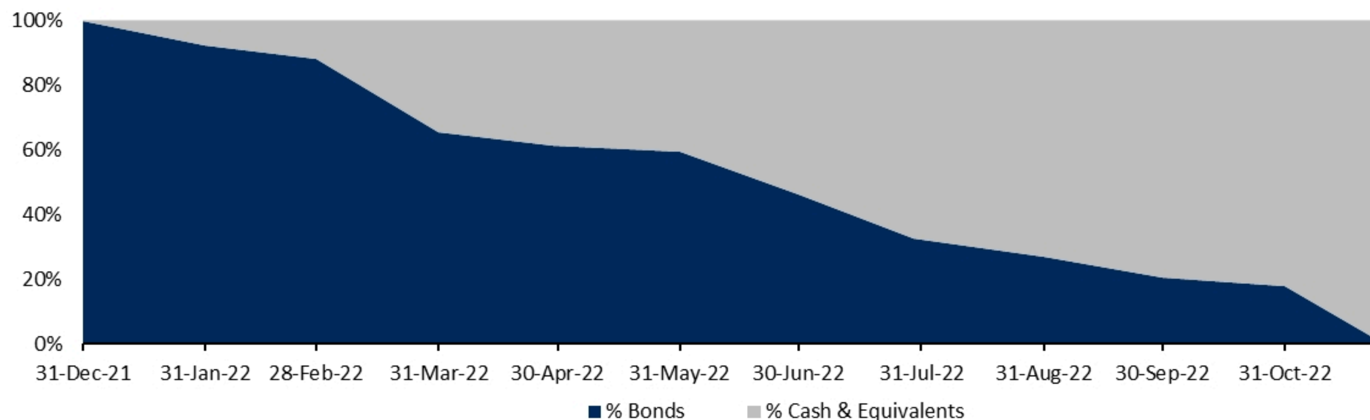
| | US Corporate TMB ETF Tickers | | | | | | |
|---|---|---|---|---|---|---|---|
| **Maturity Year** | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 |
| **RBC iShares** | - | RUQN, RUQN.U | RUQO, RUQO.U | RUQP, RUQP.U | RUQQ, RUQQ.U | RUQR, RUQR.U | RUQS, RUQS.U |
| **TD AM** | - | TBUE.U | TBUF.U | TBUG.U | - | - | - |

Source: ETF provider website; Data as of May 22, 2024.

### The Final Year of Maturity

It is important to understand how the ETF issuer manages (or plans to manage) the final year of maturity as this will likely be a key differentiator across ETF methodologies. At the beginning of the year of a maturing ETF, RBC iShares will announce the specific date when the ETF will mature. As the individual bonds held in the ETF mature, the proceeds are then invested in cash and cash equivalents with a maturity in line with the ETF's announced maturity date. As the ETF nears maturity, and as its portfolio transitions from holding 100 per cent bonds to holding 100 per cent cash (and cash equivalents), the portfolio's weighted average YTM will more closely reflect prevailing money market yields and the ETF's net asset value per unit will converge towards its par value per unit. On the maturity date, the ETF will delist from the exchange and make a final distribution of the net asset value per unit to unitholders (similar to owning an individual bond). While we have not yet seen a final year of maturity for the products offered at TD and Guardian, they are both expected to follow a somewhat similar approach but with various degrees of active management. Below is an example of how RBC slowly reallocated their matured bonds to cash in the final year of **RQJ (RBC Target 2022 Corporate Bond Index ETF)**. Please note that RQJ is no longer available for purchase as the TMB ETF was successfully delisted in 2022.

**Chart 10 - Final Year of Delisted ETF RQJ**




Source: RBC iShares; Data as of May 22, 2024.

## Final Thoughts

If we continue to see strong investor interest in TMB ETFs, it is likely other issuers will enter this growing ETF category. In addition, while it is interesting to note that TMB ETFs have represented a significant portion of overall ETF launches YTD, replacing matured TMB ETFs with new longer dated TMB ETFs is a key component of the management of this product group from an ETF issuer's perspective. Unlike traditional bond index ETF which have no expected termination date, each TMB ETF has a limited lifespan with a designated maturity date. Since RBC first entered the TMB ETF space there have been 30 ETFs launched and 11 delisted.

## GIC Yields Competitive Again

***Charlotte Jakubowicz, CMT, CIM - Vice President, Fixed Income and Currencies; Joshua Lucchetto - Fixed Income Associate***

The rates of return on fixed income instruments fluctuate based on a number of factors, including security-specific changes and broader market conditions. In the past, we've noted that Guaranteed Investment Certificate (GIC) rates may take more time to adjust to current interest rates or prevailing yields when compared to other fixed income alternatives. Said another way, other investment vehicles like bonds tend to see their yields move to reflect market expectations more quickly. With the vast majority of investment participants expecting interest rates to fall this year (at some point), it is not surprising that the front end of the yield curve is now lower. Today, short-term GICs may present a more attractive alternative to corporate bonds, so we wish to refresh readers on the pros and cons of GICs.

GICs are low-risk deposit investments issued by Canadian banks and other financial institutions, such as credit unions. When you purchase a GIC, you are lending money to the issuer for a specified term and will receive interest as compensation, typically paid annually. At maturity, your principal will be returned to you. GIC rates are influenced by the Bank of Canada's (BoC) interest rate policy. When the BoC modifies its policy rate, GIC rates tend to follow suit. Their yields are also influenced by the overall yield curve, and the issuer's funding needs.

As fixed income instruments, standard GICs provide a fixed and guaranteed interest rate throughout their term. This predictability appeals to risk-averse investors who prioritize capital preservation and steady returns, allowing them to know exactly what they will be receiving, and when it will be paid. However, in some circumstances, like today's environment, they may be attractive to a wider audience based on a competitive return profile.

A unique feature of GICs is their security and insurance coverage:

- GIC deposits are almost always eligible for coverage at each financial institution by entities like the Canadian Deposit Insurance Corporation (CDIC) or provincially run deposit programs.
- Coverage will vary by provider, by as an example, CDIC coverage is up to $100,000 per deposit category per member institution. If the issuing institution fails, coverage ensures that eligible deposits are protected.
- Credit unions that operate outside federal regulation may receive deposit insurance coverage from their provincially run program. In most cases, these credit unions offer deposit insurance that exceeds what is offered by the CDIC.
- This safety net provides peace of mind for investors.

### GIC Offerings at Raymond James

Raymond James offers a variety of GICs with different features to meet your individual needs. Key factors include maturity, liquidity, and payment frequency.

- **Term Options:** Offered GICs range from one-year to five-year terms. The majority are fixed, meaning they have a set maturity date and cannot be redeemed before that date, but some 1-year GICs are cashable, which allow investors to redeem their investment after 30 or 90 days without penalty. However, cashable GICs typically offer lower rates due to their flexibility.
- **Liquidity Considerations:** Cashable GICs provide liquidity, making them suitable for investors who may need access to their funds sooner. Fixed-term GICs require holding until maturity. There is no secondary GIC market available at Raymond James, so investors should be aware that the funds will not be accessible until the security comes due.
- **Payment Frequency and Compounding:** Interest payments can occur monthly or annually. Most investors choose annual payments for higher rates if cashflow is not required. Investors can choose to have their interest reinvested (compounded) until maturity. Compound interest occurs when interest earned from a previous period is added back to the principal, allowing you to earn interest on interest.

In summary, GICs offer a secure and predictable way to invest. By purchasing a GIC, investors lend money to the issuer for a specified term and receive guaranteed interest. At maturity, the principal is repaid along with any unpaid interest. The safety net provided by entities like the CDIC ensures peace of mind for investors. Raymond James offers various GIC options, allowing you to tailor to your investment needs. For investors that are able to accept less liquid alternatives, investing in GICs may be worth exploring, especially today where they provide improved yields over alternatives.

## IMPORTANT INVESTOR DISCLOSURES

Complete disclosures for companies covered by Raymond James can be viewed at: Disclosures https://raymondjames.bluematrix.com/sellside/Disclosures.action

This newsletter is prepared by the Private Client Services team (PCS) of Raymond James Ltd. (RJL) for distribution to RJL's retail clients. It is not a product of the Research Department of RJL.

All opinions and recommendations reflect the judgement of the author at this date and are subject to change. The author's recommendations may be based on technical analysis and may or may not take into account information in fundamental research reports published by RJL or its affiliates. Information is from sources believed to be reliable, but accuracy cannot be guaranteed. It is for informational purposes only. It is not meant to provide legal or tax advice; as each situation is different, individuals should seek advice based on their circumstances. Nor is it an offer to sell or the solicitation of an offer to buy any securities. It is intended for distribution only in those jurisdictions where RJL is registered. RJL, its officers, directors, agents, employees and families may, from time to time, hold long or short positions in the securities mentioned herein and may engage in transactions contrary to the conclusions in this newsletter. RJL may perform investment banking or other services for, or solicit investment banking business from, any company mentioned in this newsletter. Securities offered through Raymond James Ltd., Member-Canadian Investor Protection Fund. Financial planning and insurance offered through Raymond James Financial Planning Ltd., not a Member-Canadian Investor Protection Fund.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual funds. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. The results presented should not and cannot be viewed as an indicator of future performance. Individual results will vary and transaction costs relating to investing in these stocks will affect overall performance.

A member of the PCS team responsible for preparation of this newsletter or a member of his/her household has a long position in Adobe Inc., BlackRock, Inc., Costco Wholesale Corporation and lululemon athletica inc..

Securities mentioned in this publication may entail higher risk. Clients should contact their Financial Advisor to determine if the securities are compatible with their risk tolerance and investment objectives.

Information regarding High, Medium, and Low-risk securities is available from your Financial Advisor.

RJL is a member of the Canadian Investor Protection Fund. © 2024 Raymond James Ltd.