Here’s How to Invest in the S&P/TSX Composite — And Why You May Not Want To

Description

The largest equity mutual fund in the U.S. — by a large margin — is the **SPDR S&P 500**, which tracks its namesake benchmark index of America’s 500 largest companies.

The exchange-traded fund (ETF) was launched two decades ago, and its popularity is no mystery: because it acts like a traditional index mutual fund but trades like a stock, it’s dirt-cheap and highly liquid. It’s a way of investing in the overall direction of the U.S. stock market — which has been a winning strategy over the long term!

The same is true of the Canadian broad market, the S&P/TSX Composite. Today, I want to look at the index trackers Canadians can use to mimic the broad market … with a word of warning about this strategy. Without further ado …

- **iShares S&P/TSX 60 Index** (TSX:XIU) — total assets: $11.5 billion, management expense ratio: 0.18%

The iShares S&P/TSX 60 is the largest ETF in Canada and trades in excess of 4 million shares per day on average. This fund tracks a subset of the Composite index that, according to S&P, “covers approximately 73% of Canada’s equity market capitalization.” The 60 stocks it tracks are the largest of Canada’s large caps.

- **iShares S&P/TSX Capped Composite Index** (TSX:XIC) — assets under management: $1.4 billion, management expense ratio: 0.27%
- **BMO S&P/TSX Capped Composite Index** (TSX:ZCN) — assets under management: $965 million, management expense ratio: 0.15%

These ETFs track the S&P/TSX Composite, which covers 95% of the overall Canadian market. There’s one caveat — none of its 235 individual stocks can have a weighting of more than 10% in the index, dulling the effect of a few mega caps on overall performance.

Even though these are identical products based on the exact same underlying index, BMO’s product is

12 basis points cheaper, making it the no-brainer of the duo.

- **Vanguard FTSE Canada Index** (TSX:VCE) — assets under management: $158 million, management expense ratio: 0.11%

The cheapest offering of the bunch is Vanguard's, which is based not on a variation of the S&P/TSX Composite but on a FTSE index. Per Vanguard, "the FTSE Canada Index is a market-capitalization weighted index representing the performance of Canadian large- and mid-cap stocks … [that] represents about 75% of the Canadian equity market."

Vanguard is the largest mutual fund company in the U.S., with a reputation for putting fundholders' interests first by keeping costs as low as possible. It's yet to make significant inroads in Canada, but without much scale (just $158 million in assets), it *still* offers the cheapest exposure to the performance of the broad Canadian stock market. With an expense ratio of just 11 basis points, it's well below the weighted-average management expense ratio for ETFs in Canada (42 basis points).

- **Horizons BetaPro S&P/TSX 60 Bull** (TSX:HXU) — assets under management: $57 million; management expense ratio: 1.15%
- **Horizons BetaPro S&P/TSX 60 Bear** (TSX:HXD) — assets under management: $89 million; management expense ratio: 1.15%

The Horizons BetaPro Bull ETF aims for *daily investment results* equal to 200% the daily performance of the S&P/TSX 60 Index; the Bear ETF aims for daily investment results equal to 200% the inverse daily performance of the index. Meaning: the Bull is a leveraged bet on the index going up on a given day; the Bear is a leveraged bet on the index going down on a given day.

Note the words "daily investment results." These products are not designed with long-term investors in mind, so long-term investors should steer clear of them.

A word of caution about index-tracking
The broad market in the U.S. is well-represented by each of the 10 major sectors that make up the market. But as my colleague Iain Butler has pointed out, the S&P/TSX Composite is highly concentrated among just three sectors: financials, energy, and mining. Those three account for 75% of the "market," so index trackers in these ETFs may be in danger of being insufficiently diversified.

To deal with this, Iain created an exclusive free report detailing "5 Stocks That Should Replace Your Canadian Index Fund." It's designed as an easy-to-implement strategy for a diversified portfolio of stocks poised to beat the market; in fact, one of his five ideas was recently bought out at a nice premium. To see the four remaining stocks, download a copy of this FREE report by clicking here right now.

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This post was written by Brian Richards. Brian owns the Vanguard 500 index fund, but no other stocks or funds mentioned.

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1. Investing

TICKERS GLOBAL

1. TSX:XIC (iShares Core S&P/TSX Capped Composite Index ETF)
2. TSX:XIU (iShares S&P/TSX 60 Index ETF)
3. TSX:ZCN (BMO S&P/TSX Capped Composite Index ETF)

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