Trim Your iShares S&P/TSX 60 Index Fund: Buy This Global ETF With Proceeds

Description

Canadians love the S&P/TSX 60, and that's great news for **BlackRock, Inc.,** whose iShares ETF division markets the iShares S&P/TSX 60 Index Fund (TSX:XIU), Canada's largest ETF with $12.4 billion in net assets.

Whether you're a retail or institutional investor and use ETFs either as a core position or to fill some holes in your stock portfolio, there's a pretty good chance you currently own the XIU or have in the past.

It's cheap at 0.18% per year, holds 60 of the country's largest companies, and delivers a solid 2.80 yield to boot.

What's not to like?

The problem is that Canadians own too much of it. There's even a term for it: home country bias. I'm sure you've read or seen it used in your investor travels, but if you haven't, it simply means that we as Canadians have 59% of our equity holdings in domestic stocks, but those stocks represent just 3.4% of the world's market cap.

There are some good reasons why our holdings are so skewed towards Canadian equities. They include currency, local knowledge, preferential tax treatment of domestic dividends, good old-fashioned patriotism, and others, I'm sure.

But the simple fact remains that sound portfolio construction includes making sure you're sufficiently invested in the global economy, so you can benefit from the biggest and the best the world's equity markets have to offer.

No, I'm not suggesting you abandon Canada, but I am recommending you severely reduce your Canadian content by making two simple moves.

Let's say you have an equity portfolio represented by three ETFs: the XIU, the **iShares Core S&P 500 Index Fund CAD Hedged** (TSX:XSP), and the **iShares MSCI EAFE Index Fund CAD Hedged** (TSX:XIN). Given the average Canadian has 59% of their equities in Canadian stocks, we'll put the XIU weighting at 59% and both the XSP and XIN at 20.5%.

While your portfolio is 100% hedged to the Canadian dollar, virtually eliminating your currency risk, your exposure to the Canadian economy, which isn't very strong right now, has you more vulnerable than is necessary.

Sell 51% of the XIU shares and roll those into the **iShares MSCI World Index ETF** (TSX:XWD). Upon completion, 30.1% will be invested in Canadian stocks–down from 59%–while your U.S. (S&P 500) and rest-of-the-world (MSCI EAFE) content will be 38.2% and 31.7%, respectively.

By implementing these two simple moves, you've created a more balanced portfolio. However, there are two caveats.

The XWD invests in the U.S.-listed **iShares Core S&P 500 ETF** (NYSEARCA:IVV) and the **iShares MSCI EAFE Index Fund** (NYSEARCA:EFA), as well as the XIU. This means your portfolio goes from 100% hedged to the Canadian dollar to 70%. I'm willing to trade currency risk for country risk. You might not be.

Assuming this portfolio had $100,000 invested, a $30,000 move from the XIU (which charges a management expense ratio of 0.18%) to the XWD (which charges 0.46%) means the annual fees would increase from $234 to $318. Your average MER of 0.32% is still much cheaper than actively managed mutual funds or ETFs. But low-cost investors take note.

Long term, I believe you'll do better by trimming your XIU position and moving it into the XWD–higher costs and all.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:XIN (iShares MSCI EAFE Index ETF (CAD-Hedged))
2. TSX:XIU (iShares S&P/TSX 60 Index ETF)
3. TSX:XSP (iShares Core S&P 500 Index ETF (CAD-Hedged))

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Author
washworth