



Top Canadian Bank ETFs of 2022

Description

The Canadian [domestic stock market](#) is dominated by the “Big 6” bank stocks, which comprise some of the top holdings in the benchmark S&P/TSX 60 Index¹. Currently, the Big 6 bank stocks include:

1. **Royal Bank of Canada** ([TSX:RY](#))
2. **Toronto-Dominion Bank** ([TSX:TD](#))
3. **Bank of Montreal** ([TSX:BMO](#))
4. **Bank of Nova Scotia** ([TSX:BNS](#))
5. **Canadian Imperial Bank of Commerce** ([TSX:CM](#))
6. **National Bank of Canada** ([TSX:NA](#))

Together, these stocks account for approximately 20% of the broader Canadian stock market, as measured by the S&P/TSX Capped Composite Index². They form a crucial segment of the Canadian [financial sector](#), along with insurance companies and asset managers.

Investing in Canadian bank stocks is a great way to implement a [dividend growth investing strategy](#). Most Canadian bank stocks have a history of consecutive dividend increases over several decades, with no cuts or reductions, even during bear markets³.

[While Canadians can purchase individual bank stocks](#), a more hands-off and diversified approach might be purchasing a Canadian bank [exchange-traded fund, or ETF](#). Here's our guide on the top Canadian bank ETFs of 2022.

What is a bank ETF?

Canadian bank ETFs hold a basket of different Canadian bank stocks. By buying shares of a Canadian bank ETF, investors receive proportional exposure to all the underlying bank stocks. This approach can be capital efficient, as it often costs less to buy a share of a bank ETF versus a share of every single Canadian bank stock.

Like bank stocks, bank ETFs can be bought and sold daily in a market with great [liquidity](#) on most

stock exchanges intra-day. They're eligible to be traded in all [brokerage](#) accounts, including [tax-free savings accounts \(TFSA\)](#) and [registered retirement savings plan \(RRSP\)](#).

Canadian bank ETFs can come in both [passive and active](#) forms, which describes how their strategy is implemented. The differences are:

- **Passive:** These ETFs track an externally provided index of Canadian bank stocks and must replicate the index's holdings as closely as possible.
- **Active:** The ETF does not track an external index, and instead formulates its own strategy to pick and choose Canadian bank stocks with the goal of outperforming a benchmark.

Canadian bank ETFs can be also constructed using two approaches: [market capitalization](#) weighted versus equally weighted.

- **Market-cap weighted:** The underlying bank stocks are held in proportions relative to their market cap, with large-cap bank stocks receiving greater representation.
- **Equally weighted:** The underlying bank stocks are held in equal proportions, regardless of their market capitalizations.

As with all ETFs, Canadian bank ETFs will charge a management expense ratio (MER). This is the percentage fee deducted annually from your investment by the fund manager. The MER pays for the fund manager's trading, operational, administrative, and marketing costs. For example, a Canadian bank ETF with a MER of 0.20% would cost you around \$20 annually for a \$10,000 investment.

Canadian bank ETFs also provide good income potential. Many Canadian bank ETFs will aggregate the quarterly dividends paid by the underlying stocks and pay it out as a monthly distribution. Thus, a Canadian bank ETF can be a good way of getting monthly income from Canadian bank stocks that would otherwise pay quarterly dividends.

Top bank ETFs in Canada

The following Canadian bank ETFs have a combination of low fees, broad diversification, and high assets under management.

Name	AUM	MER	Distribution yield
BMO Equal Weight Banks Index ETF (TSX:ZEB)	\$3bn	0.28%	4.15%
iShares S&P/TSX Capped Financials Index ETF (TSX:XFN)	\$1.4bn	0.61%	3.27%
Horizons Equal Weight Canada Banks Index ETF (TSX:HEWB)	\$136mn	0.27%	0%

BMO Equal Weight Banks Index ETF ([TSX:ZEB](#))

ZEB is currently the most popular Canadian bank ETF in terms of assets under management. The ETF holds all of the "Big 6" Canadian bank stocks in an equal-weighted allocation, with each stock receiving

a 15-17% weighting. The ETF pays out distributions monthly and costs a MER of 0.28%

iShares S&P/TSX Capped Financials Index ETF ([TSX:XFN](#))

XFN tracks the S&P/TSX Capped Financials Index, a market-cap weighted index of Canadian financial sector stocks. In addition to Canadian bank stocks, XFN holds insurance companies, lenders, and asset managers. Still, the “Big 6” Canadian bank stocks currently account for approximately 67.3% of the ETF by weight. XFN costs a MER of 0.61%.

Horizons Equal Weight Canada Banks Index ETF ([TSX:HEWB](#))

HEWB provides equal weight exposure to the “Big 6” Canadian bank stocks like ZEB does. However, HEWB is unique as it does not pay dividends or hold the underlying stocks directly. Instead, HEWB uses a derivative called a “total return swap” to track the total return Solactive Equal Weight Canada Banks Index. Any dividends paid are automatically reflected in the total returns of HEWB, making it an efficient holding for taxable accounts. HEWB costs a MER of 0.27%.

Pros of investing in Canadian bank ETFs

Canadian bank ETFs have the following advantages:

- Hedging interest rate risk: Historically, rising interest rates have benefitted bank stocks by increasing their balance sheets, net interest income, and margins⁴.
- Liquidity: Canadian bank ETFs have high trading volumes and low bid-ask spreads.
- Simplicity: Managing a single bank ETF can be easier than manually trading and rebalancing a portfolio of multiple individual Canadian bank stocks.
- Monthly dividends: Canadian bank ETFs often pay higher than average dividends on a monthly basis.

Cons of investing in Canadian bank ETFs

Canadian bank ETFs have the following disadvantages:

- Lower diversification: Canadian bank ETFs only hold a few industry-specific (banking) stocks in a single stock market sector (financials). This can make their performance more sensitive to certain macroeconomic variables and volatile than a diversified index ETF.
- Higher fees: Canadian bank ETFs often charge a significantly higher MER than regular index ETFs do. Index ETFs can go as low as 0.04% in Canada, whereas the lowest-cost bank ETF costs 0.27%.

Are Canadian bank ETFs right for you?

The answer to this question depends on your time horizon, investment objectives, and risk tolerance. In general, an allocation to Canadian bank ETFs is best suited for long-term, intermediate-level investors who understand the sector well and are looking for above-average dividend growth.

If your goal is to hedge against increases in interest rates and maximize your monthly income, then a Canadian bank ETF might be a good holding. It can be a great hands-off alternative to manually buying and managing a portfolio of individual Canadian bank stocks.

Canadian investors should also keep in mind that most Canadian index ETFs already hold a significant allocation of Canadian bank stocks. As noted at the beginning of this article, indexes like the S&P/TSX 60 and the S&P/TSX Capped Composite already have multiple Canadian bank stocks in their top holdings. Investors who buy a Canadian bank ETF should be aware of potential overlaps in holdings.

TICKERS GLOBAL

1. TSX:BMO (Bank Of Montreal)
2. TSX:BNS (Bank Of Nova Scotia)
3. TSX:CM (Canadian Imperial Bank of Commerce)
4. TSX:HEWB (Horizons Equal Weight Canada Banks Index ETF)
5. TSX:NA (National Bank of Canada)
6. TSX:RY (Royal Bank of Canada)
7. TSX:TD (The Toronto-Dominion Bank)
8. TSX:XFN (iShares S&P/TSX Capped Financials Index ETF)
9. TSX:ZEB (BMO Equal Weight Banks Index ETF)

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Author

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