Top Canadian Index Funds of 2023

Description

Index funds are investments that follow the performance of a benchmark index.

In Canada, the best index funds offer less volatility than stocks and lower fees than actively managed mutual funds. They can diversify your portfolio by spreading your money across numerous stocks and industries. And, because they're passively managed, they don't come with high commission fees, either.

If you're looking for a low-cost investment that exposes you to the best companies in the Canadian economy while also limiting your risk, index funds might be right for you.

Below we'll break down these hefty investments and help you pick the best Canadian index funds for you.

What are index funds?

Index funds are simply investments that track a market index, such as the S&P/TSX Capped Composite in Canada or S&P 500 in the United States. They typically contain every company in that index, aiming to duplicate the index's performance.

Index funds are a part of a family of funds, which include mutual funds, exchange-traded funds (ETF), and segregated funds. Funds can be actively or passively managed. Whereas index funds track an index and thus are considered passively managed, mutual funds and ETFs may use an active, passive, or hybrid investment style.

Active funds have a fund manager who handpicks stocks to fit a certain purpose or objective. Guidedby the fund's investment strategy (e.g., value, growth), the manager chooses many individual stocks to create a diversified fund. Whereas by investing in an index fund, you can get instant portfolio diversification without all the stock-picking work. With the exception of segregated funds, you can buy these funds directly through an online brokerage (segregated funds are technically insurance products and can be bought through an insurance company).

Aside from these similarities, index funds have some notable differences. For clarity's sake, let's look at how each of these funds differs from index funds.

Mutual funds

Mutual funds can be *passively* or *actively* managed. An active mutual fund has a manager (or a team of investment professionals or financial advisors) who chooses stocks *to beat the market.* These mutual fund managers don't want to track the market; they want to outperform it. For this reason, active mutual funds come with higher management expense ratios (MERs), yet over long periods of time, they rarely beat passively managed funds. Passive mutual funds do not seek to beat but match market performance by tracking an index, and therefore have lower management fees. Mutual funds are priced at the end of each trading day.

ETFs

An exchange-traded fund (ETF) may also use a passive index investing strategy called an index ETF. One very important difference, however, is that ETFs trade during normal trading hours, like stocks. Canadian ETFs typically have lower MERs, too. Unlike ETFs, index funds don't charge commissions.

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Segregated funds

Segregated funds work like mutual fund investments, except you're guaranteed at least 75% to 100% of your initial investment (yes—even if your investments lose money). The built-in guarantee comes at a price (your premium), and you have a contract (10 to 15 years) after which you can cash out the fund.

The premium and money-back guarantee are why segregated funds aren't really investments: they're insurance products.

Index ETFs vs index mutual funds

You'll notice many brokerages will advertise index funds as either index *ETFs* or index *mutual funds*. The terminology is confusing, but it essentially boils down to this: an index ETF is an investment that *follows a major stock index*, like the TSX/S&P Composite. While plenty of index funds do this, index ETFs have the benefit of trading during normal trading hours, like stocks.

An index mutual fund is just a long-form way of writing "index fund" – a fund that passively tracks a market index but is not as liquid as an ETF that trades intraday like a stock.

Top Canadian index funds

Canada is a prime spot for index investing. Let's look at three of the best index funds in Canada.

Index Fund	MER
BMO S&P/TSX Capped Composite Index ETF (ZCN:CA)	0.06%
iShares S&P/TSX 60 Index Fund (TSX:XIU)	0.18%
Vanguard FTSE Canada All Cap Index ETF (TSX:VCN)	0.05%

Data as of December 2022

BMO S&P/TSX Capped Composite Index ETF

The BMO S&P/TSX Capped Composite Index ETF is a flagship Canadian index fund that closely tracks the S&P/TSX Capped Composite index. This index contains the largest Canadian companies trading on the Toronto Stock Exchange (TSX), which equals about 95% of the total Canadian equity market.

It's big. Another attractive feature is the management expense ratio (MER). It is super low at 0.06%. That means you'll pay only $6 for every $10,000 invested.

Overall, this Canadian index ETF is perfect for beginners who want an entry into index investing, as well as professionals who want a stable investment for a buy-and-hold strategy.

iShares S&P/TSX 60 Index Fund

Another heavyweight among Canadian index funds is the iShares S&P/TSX 60. As its name suggests, this index fund tracks the S&P/TSX 60 market index, which contains the 60 biggest stocks by market cap trading on the TSX.

Not only is the S&P/TSX 60 Index Fund the *oldest* Canadian ETF on the market, but it also has the largest equity size. The index fund has a low MER at 0.18%, and its compound annual growth has been 7.9% since 2002.

Much like the S&P/TSX Capped Composite Index ETF, this index fund is perfect for long-term investors, both beginners and experts alike.

Vanguard FTSE Canada All Cap Index ETF

The FTSE Canadian All Cap Index is a market index comprised of large, mid, and small cap Canadian stocks. These stocks are themselves picked from the FTSE Global Equity Index Series, which represents around 98% of the world's investable market.

What's so great about this index fund? Well, for one, it gives you broad exposure to different kinds of stocks in the Canadian market. Whereas the two index funds above will expose you to large cap companies (companies with market caps above $10 billion), this index ETF will also expose you to mid and small cap growth companies.

The index fund also has a low MER (0.05%). For broader diversification, the Vanguard FTSE Canada All Cap Index ETF is a solid pick, especially if you're already invested in the two index funds mentioned above.

Are index funds right for you?

Index funds are a great passive investment that can expose you to a wide breath of high-performing Canadian companies at a low cost. Many index funds pay a dividend, which makes them ideal for Canadian investors who want fixed income from their investments but don't want to handpick their own dividend stocks.

Index funds are also ideal for investors with a long-time horizon, as their most volatile periods will be evened out with longer periods of positive returns. They're a great retirement savings vehicle, too, as you can open one up within a TFSA or RRSP.

The best index funds in Canada will have low MERs and no trading commissions. They track viable markets, and typically have a long track record of positive returns. Much like choosing individual stocks, you can better diversify your portfolio by buying shares in multiple index funds. Index fund diversification helps you manage your risks, while also getting the best returns possible.

TICKERS GLOBAL

1. TSX:VCN (Vanguard FTSE Canada All Cap Index ETF)
2. TSX:XIU (iShares S&P/TSX 60 Index ETF)

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1. cleona
2. metienne
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