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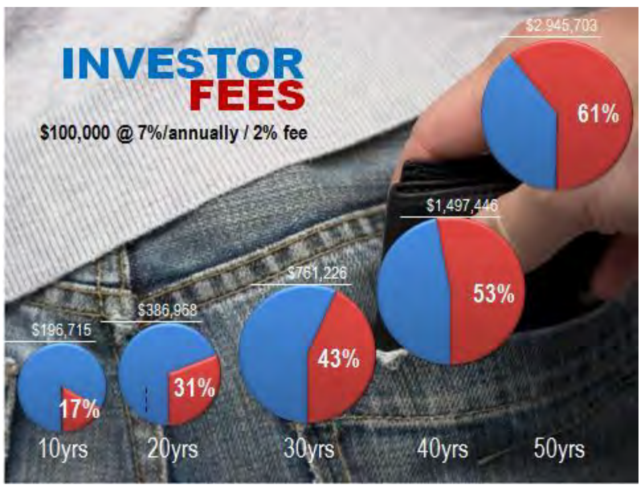
FINANCIAL SERVICE INDUSTRY CHARACTERISTICS
"The Retirement Gamble" Frontline (PBS), April 2013, included an interview with founder and former CEO of Vanguard Investments, John (Jack) Bogle. He is a champion for the rights of the small investor.

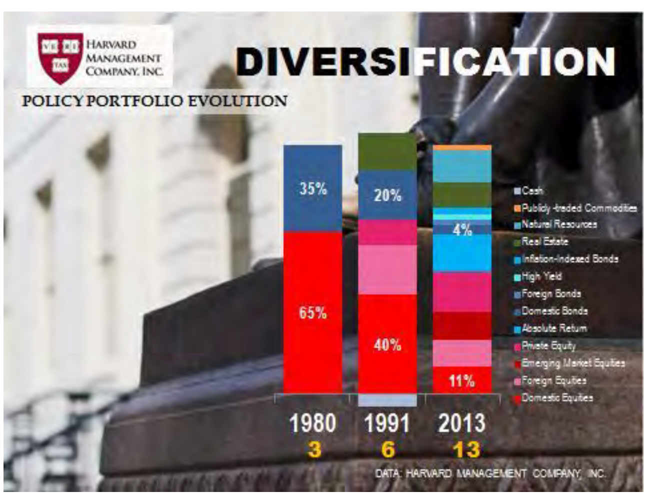
Mr.Bogle observed the impact of investing fees on returns.



ONE FOR YOU TWO FOR ME
A $100,000 investment compounding at 7% a year with 2% in fees deducted each year shows how well the industry removes money from investors' pockets.

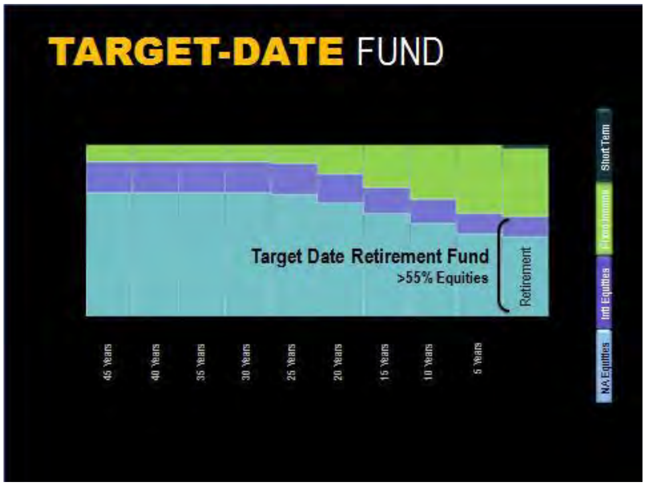
After 50 years, fees consume 61% of accumulated capital.

Investors put up 100% of the money, take 100% of the risk and get only 40% of the return. Investors in "wrap" accounts and other programmes with fees in the 3.0%-3.5% range get to keep only 20%-25%!



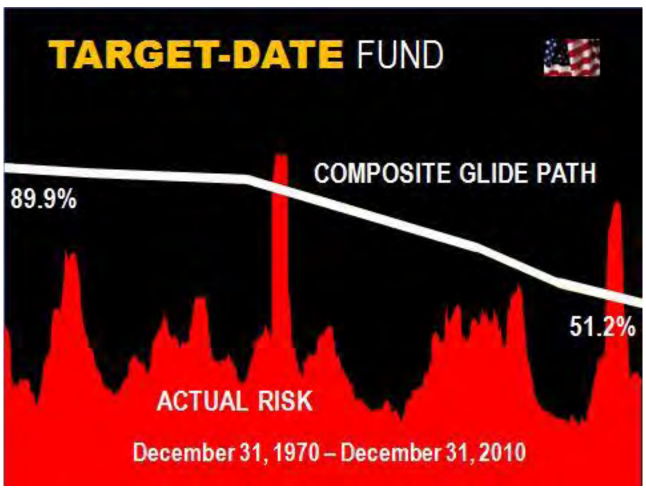
TOOL IS A HAMMER, PROBLEMS ARE NAILS
In the absence of significant breakthroughs in investment theory since CAPM was introduced 50 years ago, professional investment managers' only tool for fighting risk (volatility) has been diversification.

The evolution of the Policy Portfolio for the management of the Harvard University Endowment is a good example of how managers have expanded asset classes to manage risk.



GOOD MARKETING!
The most successful investment product in the U.S. pension market in recent years has been the target date fund (TDF). It automatically adjusts portfolio asset allocation to become more conservative as retirement approaches, alleviating the unitholder from periodic rebalancing and asset allocation decisions. It makes investing simpler.

What investors think is that the portfolio is becoming less risky as the target date approaches. This is what they buy, subsequently 2 of every 3 new dollars into DC plans go into TDFs.



ACTUAL TARGET DATE FUND RISK
A glide path (asset weighted by the three largest providers of TDF in the U.S.) was established and historically tested using the risk of the S&P 500 for equities and zero (cash) for the balance.

If risk were actually being reduced as the target date approached, the red area would have paralleled the white line.

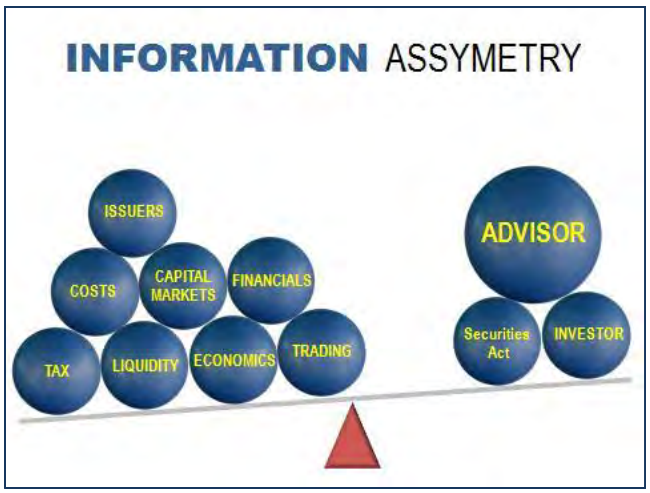
There seems to be little relationship because risk in capital markets is not static.

PERFORMANCE AND NUMBERS
Past performance is no indication of future performance and there are no guarantees that markets in the past will be the same. This must be true because we tell investors this all the time.

Nevertheless the first and often the last thing investors rely upon in making investment decisions is what did well last year. Lazy advisors use performance to make the easy sale knowing full well that process is more important than performance.

DOING BETTER
Lower fees, cost-effective diversification, product and service transparency, and a shift from performance to process would all benefit investors.

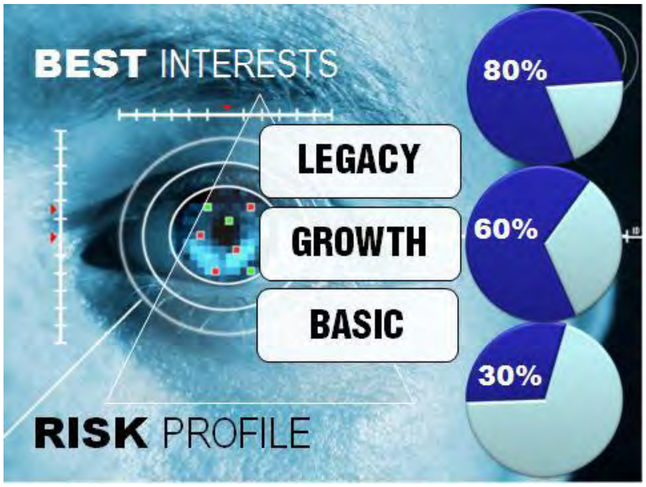
These are things that ETFs can do.



LEVELLING THE FIELD
Rationalizing compliance and getting advisors back to the investor side, would benefit investors by reducing cost escalation, promote innovation rather than bureaucracy and can be accomplished by promoting fee-based relationships. ETFs are ideal instruments to promote fee-based practices because they unbundle the investment management component.

ONE SIZE FITS ALMOST NOBODY
Regulatory suitability standards were devised in the 1950's and haven't advanced much if at all. Investors suffer as a result. The standards focus on individual securities and are designed to prevent advisors and clients from acquiring inappropriate investments. But we have already seen that diversification has been the leading tool for risk mitigation for 50 years. Suitability doesn't address risk as we understand it today.

Good intentions have not been translated into better standards.



BEHAVIOURAL FINANCE
Building portfolios that relate to client goals is the objective of effective portfolio management.

ETFs help by providing efficient instruments of pre-diversified risk with which to construct very personal portfolios with a degree of precision not possible before except for very large portfolios. ETFs have helped to democratize portfolio management so that institutional approaches can be harnessed by individuals.

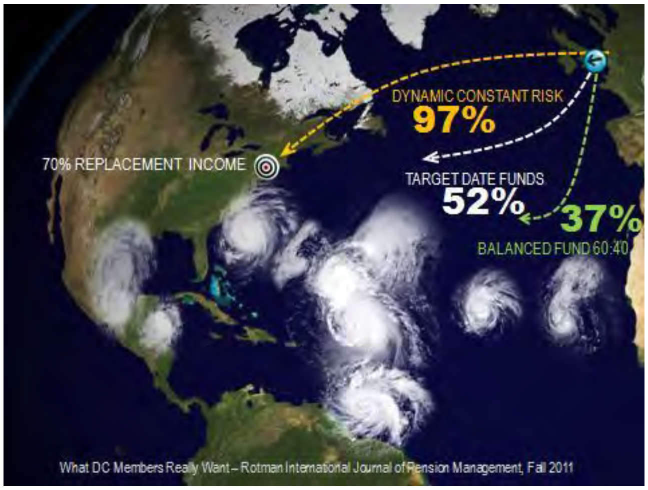
TECHNOLOGY BUBBLES AND BATHWATER
The volatility (SD) of the S&P 500 rose as the Technology Sector's weight in the S&P 500 rose from about 8% to over 30% from 1990 to 2000.

Balanced fund and pension managers sold stock as the market advanced, rebalancing to a fixed asset mix like 60% equities and 40% bonds, intuitively the right thing to do; buy low, sell high. But risk in 1990 wasn't the same as in 2000.

Like bath water temperature, risk can be adjusted if it gets too hot or cold.

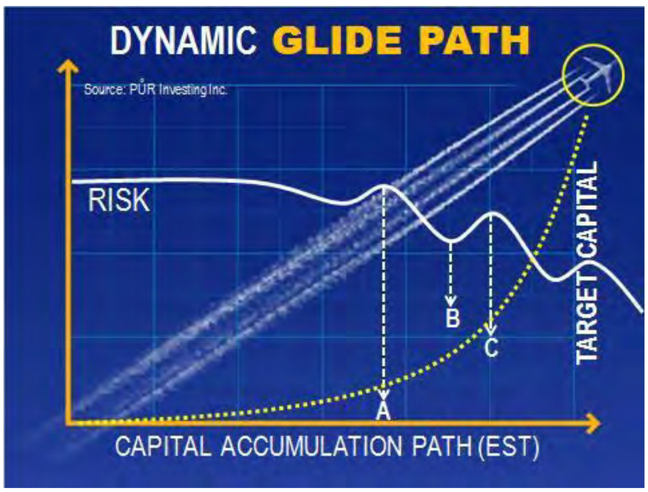
WHAT DC PLAN MEMBERS REALLY WANT
In a paper for the Rotman International Journal of Pension Management, we pondered the question about what DC plan members really want.

The answer is a DB plan, or more precisely a reliable stream of replacement income in retirement managed by somebody else.



LANDING ON TIME

We tested various strategies for their ability to deliver a DB-like 70% replacement income. The popular 60:40 Balanced fund did so 37% of the time, TDFs 52% of the time and our approach using two ideas that we developed for ETF portfolios, 97% of the time.



DYNAMIC CONSTANT RISK

By establishing target capital, we derive a capital accumulation glide path. Actual experience will be above or below this. We change the RISK of the portfolio depending upon how the portfolio is doing against the expected path. We take a little more risk if we are behind ((A and C) and a little less if we are ahead (B).

CHALLENGES

As practitioners, regulators, and researchers and perhaps even academics, we need to ask ourselves whether what we do encourages innovation and champions best practices.

That is unfortunately not the case today. ETFs offer great promise and provides investors and their advisors with better and more flexible tools to address the key challenges that face us all today.