Innovation ETFs seek to sate investor appetite for the next big thing

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Investment funds tracking companies described as innovative and disruptive are attracting dollars both in the United States and Canada, but investors need to check out what's under the hood, as these products can include a broad range of companies.

Evolve ETFs is set to begin trading the Evolve Innovation Index ETF on the Toronto Stock Exchange on May 2. Under the ticker EDGE and with a 0.40-per-cent management fee, the ETF will give Canadian investors access to a portfolio of global companies involved in six main categories: big data and cloud computing, robotics and automation, genomics, future cars, cybersecurity and social media.

But the ETF will also be in part a "fund of funds," as its weightings include two underlying ETFs: the Evolve Automobile Innovation Index ETF (CARS) and the Evolve Cyber Security Index ETF (CYBR). These top holdings of the Solactive Global Innovation Index – which the fund will track – won't be available to investors until the fund starts trading next week, but Raj Lala, president and chief executive of Evolve ETFs, says EDGE will provide access to all the emerging industries in a single investment.

"There is a big subset of the population that sees all the changes that are going on in our world, whether it's autonomous vehicles around the corner or robotics technology," Mr. Lala said. "There are so many different developments that are going to become integrated into their life, but they don't necessarily know what area is the right one to be invested in today."

As more companies begin to include robotics, artificial intelligence and emerging trends into their platforms, the plethora of innovative companies continues to expand. The problem with this rapid growth is that the majority of these "disruptors" are large technology companies already found in a typical U.S. or global equity fund.

But clearly there is investor appetite for a basket of the next big thing. Last Fall, Fidelity Investments Canada ULC launched the Fidelity Global Innovators Class, which drew more than $1-billion in assets in less than four months. With a management fee of 2 per cent (for an A-class fund) and managed by Mark Schmehl, the fund includes stocks from a variety of sectors, including technology, copper mining and health care.

Mr. Schmehl points to Etsy, a stock he recently added to the fund, as a company that some may not consider a disruptor.

“Etsy was a mismanaged company that now has new management,” he said. “This new team is implementing simple and sensible changes which, while not revolutionary, do represent the best practices in the e-commerce industry. It’s amazing how simple changes can improve both the buying behaviour of customers on these marketplaces and economics of the business.”

Focusing on companies set to disrupt their sectors isn’t an entirely new investing theme.

In the United States, ETF provider ARK Invest launched an actively managed ETF that focuses on the theme of disruptive innovation in 2014. With a 0.75-per-cent management-expense ratio and under the ticker ARKK, the ARK Innovation Fund currently has US$689-million in assets under management and looks to invest in companies that rely on or benefit from the development of new products or services, technological improvements and advancements in scientific research. Since inception, the fund has seen an annualized rate of return of 22 per cent and current top holdings include Telsa Inc., Stratasys Ltd., Athena Health Inc., Twitter Inc. and Amazon.com Inc.

Other innovation funds may appear similar in nature, but investors should not be quick to assume.

Earlier this year, First Trust Portfolios Canada launched the First Trust Indxx Innovative Transaction and Process ETF. Despite having the word “innovative” in its name, the fund focuses exclusively on the blockchain technology industry by tracking the Indxx blockchain index. The broader name came from a similar fund the firm first launched in the United States, where regulators currently request that fund companies not use the word “blockchain” in the names of investment funds.

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