STOCKTRADES ETF SUMMARY

ZUQ.TO

BMO MSCI USA HIGH QUALITY ETF

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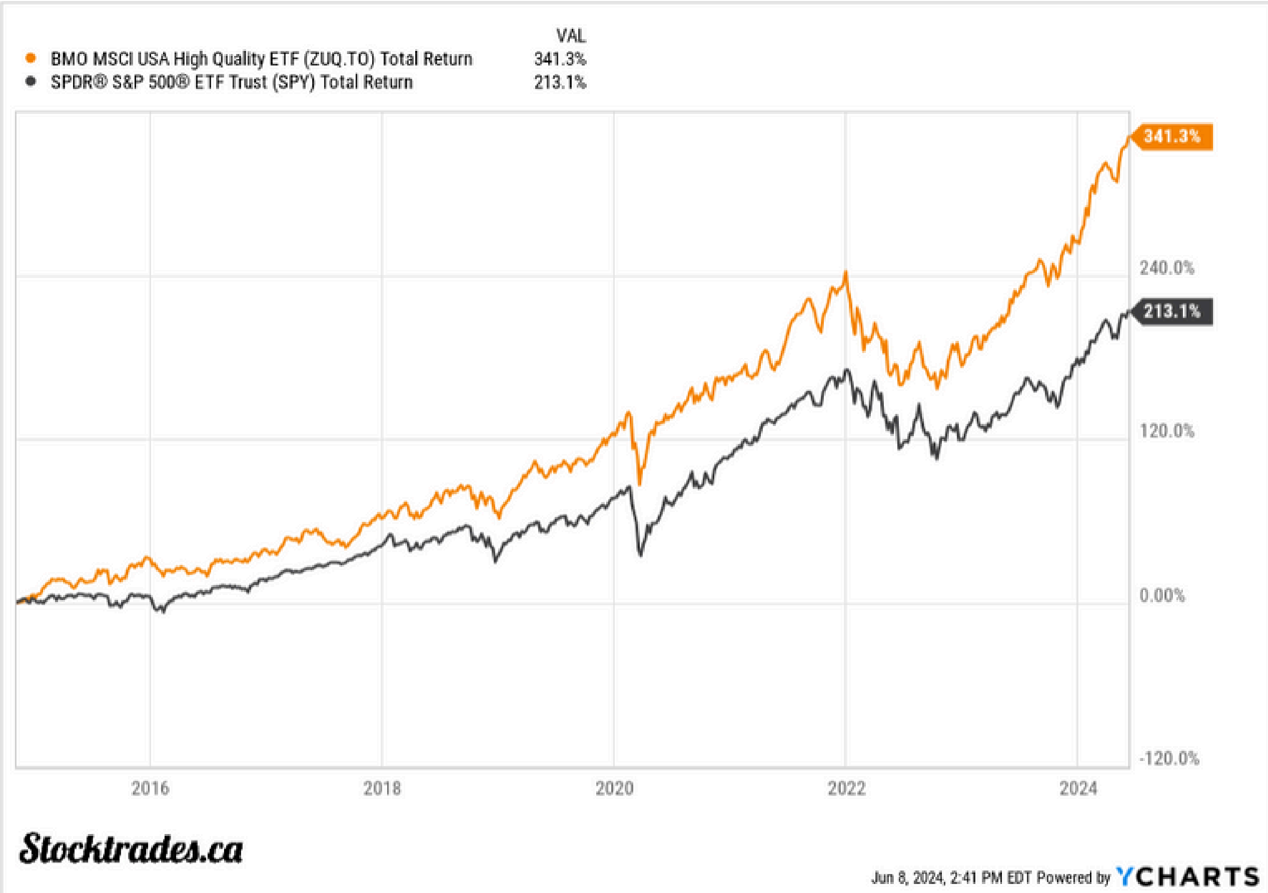
Stocktrades ETF Insights



Performance (CAGR)	**17.25%**	★★★★★
Fees (MER)	**0.33%**	★★★
Volatility (Beta)	**0.72**	★★★★★
Distribution (Yield)	**0.76%**	★★★
Valuation (Forward P/E)	**25**	★★
5 Year Earnings Growth	**9.78%**	★★★★

Performance: The fund's 10-year annualized returns, or all-time annualized returns if the fund is less than 10 years old.
Fees: The fund's total fees, including the trading expense ratio. A lower star rating means higher fees. However, a high-fee fund could have a high fee rating if its performance has justified the fees.
Volatility: The historical volatility you can expect from the fund. A lower star rating means more volatile. We base this on a combination of the beta and max drawdown of the fund.
Distribution: The yield of the fund. A more tax-efficient ETF will get bonus stars.
Valuation: The overall valuation of the companies inside of the fund.
5 Year Earnings Growth: The expected earnings growth of the fund annualized over the next 5 years. A lower star rating means lower expected growth.

PROS

- An isolated portfolio of the highest quality US stocks. I like the way the underlying index of this fund selects its holdings
- The fund has consistently outperformed the S&P 500 since its inception
- The fund has CAD and USD-listed funds, allowing flexibility for investors
- Over the last few years, the funds trading expense ratio is 0%

CONS

- The isolation of a smaller basket of US names over a simple S&P 500 ETF like VOO results in higher fees. Although these fees have been worth it thus far, there is no guarantee the fees will be worth it moving forward

OBJECTIVE AND STRATEGY OF THIS ETF

The S&P 500 is considered one of the most stable, best-performing indexes on the planet. However, not all of the companies within the S&P 500 are of the highest quality. The BMO MSCI USA High Quality ETF (TSE:ZUQ) attempts to take advantage of this by selecting a more concentrated portfolio of high-quality US names.

The fund tracks the MSCI USA High Quality Index. The index has three main goals when selecting holdings. First, it looks for companies with high returns on equity, one of the strongest indicators of a high-quality company available to investors. It then looks at historical numbers and identifies the companies that have put up the most reliable earnings growth historically.

Finally, it looks at the company's debt structure, primarily through the debt-to-equity ratio. Companies with high debt levels and low shareholder equity will ultimately be excluded. This is why, for example, we see no utility exposure inside the portfolio at the time of update. They typically carry high levels of debt relative to their shareholder equity. This doesn't necessarily mean they are poor companies; they just don't fit MSCI's quality score rating.

If a company meets the threshold of MSCI's score rating, it will then be shortlisted and the highest quality of prospects will be selected for this more concentrated portfolio. Thus far, its system has worked well.

RISKS OF THIS ETF

One of the key risks associated with this fund is the exposure to the United States economy. Because this is an index fund that tracks particular US large-cap stocks based on a "quality rating" designed by MSCI, it depends on the success of those underlying companies, all of which are in the United States. Although the US economy has been one of the strongest economies on the planet for quite some time now, there is no guarantee that this will continue moving forward. A second risk would be the concentration in technology-based companies. This fund has over 130 holdings at this point, but nearly 40% of those are located in the tech sector.

Sector Risk	**LOW**
Concentration Risk	**MED**
Geographical Risk	**HIGH**
Liquidity Risk	**LOW**

The sector's performance has been outstanding in the past, but again, there is no guarantee it will continue to perform well moving forward. A struggle among the major technology companies included inside this ETF would result in a high likelihood of underperformance relative to global indexes.

Another risk is currency risk. ZUQ is not currency-hedged, meaning you are exposed to USD and CAD fluctuations. The phrase with unhedged ETFs is often "you own both the stocks and the currency." Depending on your time horizon and risk tolerance, hedging could be needed.

HOLDINGS

Top Ten Holdings	Allocation
NVIDIA (NVDA)	7.6%
Eli Lilly (LLY)	5.8%
Meta Platforms (META)	5.6%
Broadcom (AVGO)	4.6%
Microsoft (MSFT)	4.6%
Apple (AAPL)	4%
Visa (V)	3.9%
Mastercard (MA)	3.5%
UnitedHealth (UNH)	3.24%
Alphabet (GOOG)	3%

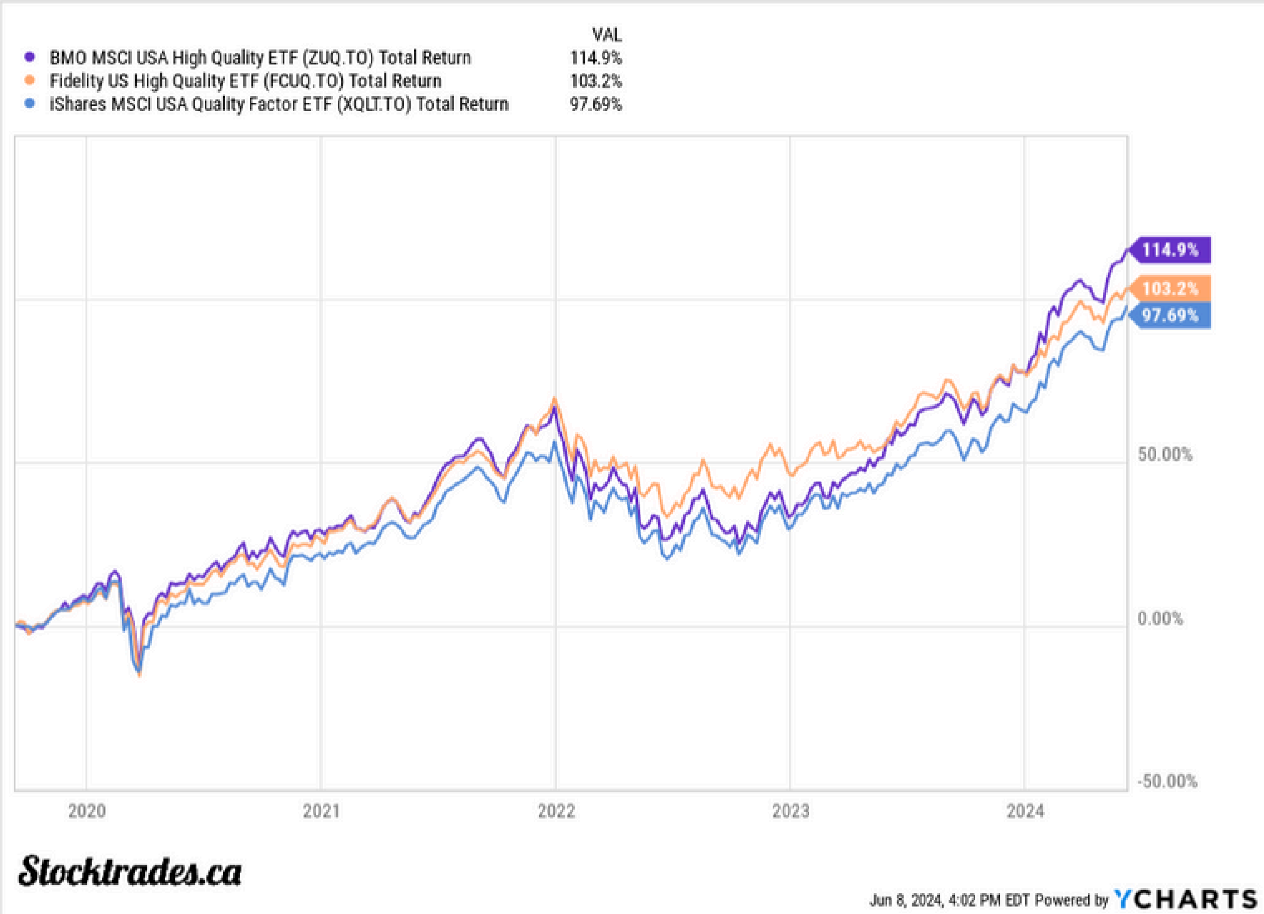
When you think of an ETF that contains only the highest quality US stocks that pass relatively strict profitability, growth, and debt metrics, you likely wouldn't be surprised at all with the top holdings of this fund. It contains some of the best technology companies on the planet. It mixes in a few payment processors in Visa and Mastercard, both with arguably untouchable economic moats due to their payment networks.

Outside of that, you have a few pharma companies in Eli Lilly and UnitedHealth, although UnitedHealth is more on the insurance side of things. Regardless, US healthcare is a big money business, which is why you see these two holdings inside the top 10.

The fund has around 130 holdings, give or take, and it is certainly top-heavy in that regard. The top 5 holdings make up nearly 30% of the entire fund, with the 25th largest company in the portfolio making up just 1%.

The concentration is not a deal breaker for me, as the S&P 500 is nearly just as concentrated, with the top 5 holdings making up around 26% of the index. However, there is a key difference between the S&P 500 and ZUQ, that being, the top 5 holdings of the S&P 500 contain Amazon and Apple, while ZUQ replaces them with Broadcom and Eli Lilly.

COMPETING FUNDS



	ZUQ	FCUQ	XQLT
Returns	✅		
Diversification	✅		
Fees	✅		
Tax Efficiency	✅	✅	✅
Distribution	✅	✅	✅

There are plenty of funds out there that track high-quality US names. However, the three largest are BMO's ZUQ, Fidelity's FCUQ, and iShare's XQLT.

Where these funds are nearly identical is in their tax efficiencies and distributions. All three of them yield between 0.70%-0.8%, so it's not a fund you own if you're looking for income. Regarding the tax efficiencies of the funds, they're all Canadian-domiciled ETFs that own either US-listed ETFs or US-listed stocks, so even inside an RRSP, they'll be subject to withholding tax. If you'd like to avoid this, you'd need to exchange currencies and seek out a USD-listed ETF that tracks high-quality US names. Considering the distribution is small, I wouldn't be too concerned about it, however.

The fees are almost identical as well, with all 3 funds having just 3-4 basis points (0.03%-0.04%) difference. I gave the edge to ZUQ because although it has a higher fee, its outperformance over the last while has more than justified this fee.

The likely outperformance of BMO versus iShares XQLT is that iShares tracks a "sector neutral" index. This primarily means the fund won't go overweight on any particular sector. As a result, it has 10%~ lower technology exposure, which has likely resulted in lower overall returns.

In terms of Fidelity's underperformance relative to BMO's, it tracks its own constructed index. When we dig into why these funds are different, it will ultimately come down to the parameters set by the underlying index and how they choose their companies and allocations towards those companies. Fidelities index contains much more exposure to energy, while ZUQ contains 0% energy exposure, which has likely driven stronger returns over the long term for ZUQ.

DISTRIBUTION ANALYSIS

ZUQ doesn't pay much of a distribution, typically yielding around 0.7%. The reasoning for this is relatively simple. Generally, when we are looking at higher quality names in terms of returns on equity, debt profiles, and earnings growth, the lower-yielding, higher quality names that are reinvesting heavily back into the business to drive earnings growth will not pay much of a dividend.

This is in contrast to older, more mature companies, which typically have slower earnings growth and declining returns on equity to the point where paying out a dividend is often seen as the better form of capital allocation.

This doesn't necessarily make those more mature holdings poor companies. They're just at a much different point of the business cycle than most of the companies held inside ZUQ.

OUR OVERALL OPINION

I'm a fan of ZUQ. I like the methodology of the underlying index to isolate higher-quality US names outside of the major index in three key areas that I appreciate as an individual investor.

This isn't an actively managed fund where there is human error and management missteps either; this is simply an index fund with a calculated methodology to selecting its stocks. Sure, there is no guarantee that this methodology will continue to work moving forward, however with its history of strong returns I am inclined to believe there is a good chance that it will.

For Canadians, it gives us solid exposure in our home currency to high-quality US names at a reasonable fee. One could save a bit in fees to simply own the S&P 500 in USD (VOO with a management fee of 0.03%), but thus far the parameters required for companies to fit this index has resulted in it outperforming the S&P 500.

It is more concentrated than the S&P 500, which likely means there are added risks in that regard, especially when it comes to US tech stocks, but the S&P 500 is heavy in US tech as well.

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