

Exchange Traded Fund (ETFs)



Blackstone Moregate
Independent Financial Advisors

ETFs are investment products that offer an alternative to traditional investments in stocks, bonds or mutual funds. These are index-tracking funds that can be traded on stock exchanges just like stocks – so they combine the diversified holdings of a fund with the low cost and tradability of a share.

ETFs work rather like index-tracker unit trusts or open-ended investment companies (OEIC's), holding a portfolio of shares, commodities or other securities to replicate the performance of an index, sector or asset class. But they generally have lower management charges, and can be bought and sold at any time through a stockbroker, rather like closed-ended investment trusts. Also like investment trusts, their prices change continuously throughout the trading day, reflecting the value of the assets they track, and sentiment in the market.

Simply put, ETFs allow you to buy an entire market in just one trade.

Benefits of Exchange Traded Fund (ETF)

ETFs offer a number of advantages over conventional unit trust funds, open-ended investment companies (OEIC's) and investment trusts, in terms of their cost, their tax status and their ease of trading. This makes them a very useful tool for diversifying a portfolio and managing risk.

- **Low Charges**

ETFs are very low-cost investment products: the total expense ratio (TER) of ETFs can be as low as 0.15-0.5 per cent, compared with TERs on traditional unit trusts and OEIC's of 1.5 per cent or more. That's because there are no front-end fees or charges for active fund management. Investors only pay stockbroker's commission to buy in.

- **No Stamp Duty**

Unlike conventional UK shares, ETFs do not incur 0.5 per cent Stamp Duty when you buy them.

- **Tradability**

ETFs are easy to trade as prices are quoted continuously, allowing investors to buy or sell throughout the trading day. Designated market-makers offer real-time, two-way prices, with tight spreads between the quoted buying (offer) and selling (bid) prices. Liquidity is also ensured as ETF shares can be created according to demand.

- **Tax Efficiency**

ETFs generally generate relatively low capital gains, because they typically have low turnover of their portfolio securities. While this is an advantage they share with other index funds, their tax efficiency is further enhanced because they do not have to sell securities to meet investor redemptions.

- **Diversification**

ETFs offer a highly cost effective way of spreading portfolio risk by adding diversified exposure to a range of asset classes, through a single shareholding. Just one ETF can track an entire international equity market or sector, a whole index of government or corporate bonds, a basket of commodities, or a single commodity, such as oil.

- **Transparency**

ETFs, whether index funds or actively managed, have transparent portfolios and are priced at frequent intervals throughout the trading day.

Comparison between ETF and Mutual Funds

Exchange Traded Funds, or ETFs, as they're commonly known, far eclipse mutual funds in so many ways that, frankly, mutual funds are no longer a competitive product. If you own mutual funds, or if you don't own ETFs, now might be a good time to review the benefits of ETFs to determine if they might be right for you.

Here are the immediate advantages you get from owning an ETF versus a mutual fund:

ETFs offer an almost limitless variety of options including basic indexes, different styles and a wide variety of sectors to achieve any level of diversification you want.

- ETFs are optionable for traders interested in options trading.
- ETFs offer "ultra" funds, or leveraged funds which can move as much as double the underlying index and so offer aggressive investors a way to leverage their investments, even within qualified accounts
- An ETF trades like a stock and so you get continuous pricing throughout the day and the chance to buy or sell throughout the day compared to the inflexibility of end-of-day pricing for mutual funds.
- ETFs can be sold short like a stock which isn't possible with mutual funds.
- ETFs can be bought on margin.
- ETFs can use limit and stop orders so you can exit or enter during the trading day.
- ETFs have lower expenses than mutual funds and no management fees.
- ETFs offer "inverse" funds which move opposite to the underlying index and so can be used to "short" the market.

Lower Expenses and Tax Savings

When it comes to expenses, ETFs have it all over mutual funds. An average actively managed mutual fund expense ratio is approximately 1.5% while an index fund is about 0.19%, but a typical ETF expense ratio is only about 0.13%.

ETFs are also far more tax efficient than mutual funds because you don't get the capital gains and income hits that you can get from a mutual fund, often unexpectedly. Mutual funds pass along their gains annually and so you can be taxed on gains you never made if you enter the fund after the beginning of the year. Conversely, ETFs don't distribute gains and a dividend unless you're an owner on the date payment is declared.