

# what is an ETF?

simplifying  
investment  
strategies  
and market  
trends

An Exchange Traded Fund (ETF) is an investment vehicle designed to track a particular index by offering ownership in a basket of securities that replicate that index, such as the S&P 500 or the Dow Jones Industrial Average. ETFs trade like stocks on major exchanges and offer several benefits such as lower expense ratios, trading flexibility and tax efficiency.

Low Ownership Costs	*			*
Tax-Advantaged Product				*
Near Instant Liquidity	*			*
Portfolio Transparency	*		*	*
Trade At or Near NAV				*
Fully Invested	*		*	*
Sell-Short or Down-Tick				*
Diversification		*	*	*
Managed Portfolios		*	*	*
Options	*			*
	Stocks	Mutual Funds	Managed Accounts	Exchange Traded Funds

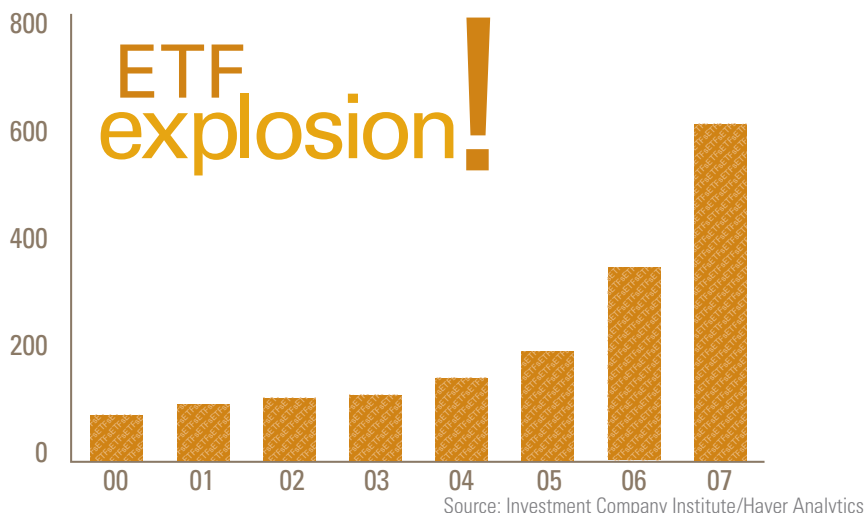
Source: Powershares

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## Variety of Objectives Offered Using ETFs

ETFs were first introduced in 1993, tracking the S&P 500. At that time there were only a few ETFs with about \$500 million in assets. Now there are more than 700 ETFs available, with assets totaling more than \$570 billion. Initially, large institutions embraced ETFs as a lower-cost passive investment solution that would simply track the broad market. Now, both institutional and retail investors looking to meet a range of investment objectives use ETFs. They can be used to gain exposure to broad asset classes, sectors, or targeted industries within the U.S. and other countries. ETFs can also be used to track various segments of the fixed income market.

Growth of the number of different ETFs available



Talk to your advisor for more information, and to see if ETFs might fit your investment plan.

### ETFs vs. Traditional Mutual Funds

While there are some similarities between ETFs and traditional mutual funds, there are also meaningful distinctions. Both offer a way to gain diversified exposure to a broad market, market segment, asset class, style, or geographical region. To understand some of the differences, it is helpful to look at the actual mechanics of how an ETF works compared to traditional mutual funds.

A “market maker,” a firm that stands ready to buy and sell a particular stock on a regular and continuous basis at a publicly quoted price, builds an ETF. The market maker builds the fund by acquiring, in proportion, all the underlying holdings in the index that the ETF is designed to track, thus replicating the index. A share of the ETF represents partial ownership in that basket of securities, and offers the benefits of passively investing in a broad range of equities.

So, when an investor purchases shares of an ETF, they are buying a vehicle that represents their ownership in a basket of securities. Unlike a traditional mutual fund, if one shareholder sells shares, the action does not create a sales event for other shareholders, because the assets are not commingled with the assets of all the other shareholders who own the ETF. This difference allows the ETF owner to more effectively manage and control tax efficiency.

Another distinction is that ETFs trade on a public exchange continuously throughout the day, while any purchase or sale of a traditional mutual fund occurs only at the closing NAV price that day.

### Passive vs. Active Management

ETFs are typically considered passive investment vehicles, because they are designed to track a particular index and match the benchmark’s performance



before fees and expenses. The objective for an actively managed mutual fund is usually to beat the market benchmark by selecting investments the manager feels will outperform. Therefore, an actively managed fund has the opportunity to outperform (and runs the risk of underperforming) its benchmark, while the ETF can only match it.

Because there is now a wide variety of ETFs, the investor needs to decide not only to what segment of the market she wants exposure – such as large cap equities, for example – but also which definition of that segment best suits her investment goals, because various companies offer indexes that track essentially the same market segments, but with some variance from each other. For instance, Standard & Poors, Russell, and Dow Jones Wilshire each define a large cap index, but do that using the largest 500 companies, largest 1000, and largest 750, respectively.

### Increased Control over Tax Implications

As mentioned, the fact that investors' assets are not commingled in an ETF as in a traditional mutual fund can make ETFs relatively more tax efficient. In a traditional mutual fund, the investor may be impacted by the actions of other shareholders, as capital gains are distributed equally to all investors, regardless of how much of that gain the investor participated in. However, the structure of the ETF can give an investor much the same control over purchases and sales as an owner of a stock, because the market maker delivers a basket of securities to the fund manager in exchange for ETF shares that are then delivered to the investor.

### Trading Costs and Expenses

There are trading costs associated with investments in ETF's. If purchased into an advisory account, there is a ticket charge for each purchase, and for brokerage accounts ETF purchases are subject to a commission schedule. These charges can quickly add up if investments are made frequently. ETFs may have very low expense ratios because there is no active management component.

**Talk to your advisor for more information, and to see if ETFs might fit your investment plan.**

Overall, there can be many benefits to utilizing Exchange Traded Funds. They can provide an inexpensive, flexible alternative to traditional mutual funds. They can also be used to gain diversified exposure to a particular asset class, sector, industry, country, region or fixed income asset class. Due to their structure and trading characteristics, ETFs may also provide greater control over the tax implications of your investments. The development of new and more sophisticated ETF products means that an investor should make well-informed decisions about adding them to a portfolio. Speak with your financial advisor to see if ETFs make sense for you.

Sources: LPL Financial Research, iShares, SSGA, Vanguard, Powershares, WisdomTree, AMEX, NYSE, etfconnect.com, Investment Company Institute (ICI), Haver

**IMPORTANT DISCLOSURES**

Exchange-traded-funds (ETFs) offer shares that trade in the secondary market. Because ETFs are listed on exchanges, individual ETF shares can be bought and sold throughout the trading day at the current market price. The general level of stock or bond prices may decline, thus affecting the value of an equity or fixed income exchange traded fund, respectively. Moreover, the overall depth and liquidity of the secondary market may also fluctuate. Therefore, value of the shares, when redeemed, may be worth more or less than their original cost. Due to market conditions, ETF shares trading on the exchange may be available for purchase at a premium or discount to NAV.

Although exchange traded funds are designed to provide investment results that generally correspond to the price and yield performance of their respective underlying indexes, the trusts may not be able to exactly replicate the performance of the indexes because of trust expenses and other factors.

**Principal Risk:** An investment in an Exchange Traded Fund (ETF), structured as a mutual fund or unit investment trust, involves the risk of losing money and should be considered as part of an overall program, not a complete investment program. An investment in ETFs involves additional risks: not diversified, the risks of price volatility, competitive industry pressure, international political and economic developments, possible trading halts, Index tracking error.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing.

All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

Small-cap stocks may be subject to a higher degree of risk than more established companies' securities. The illiquidity of the small-cap market may adversely affect the value of these investments.

International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

Investing in mutual funds involve risk, including possible loss of principal.

Investments in specialized industry sectors have additional risks, which are outlined in the prospectus.

**Investors should consider the investment objectives, risks and charges and expenses of the investment company carefully before investing. The prospectus contains this and other information about the investment company. You can obtain a prospectus from you financial representative. Read the prospectus carefully before investing.**

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