

# ETF Basics

An exchange-traded fund (ETF) is a basket of securities designed to replicate the performance of a stock or bond index (e.g., S&P 500, Dow Jones Industrial Average). ETFs are listed on an exchange and can be traded intra-day at a price set by the market.

ETFs add the flexibility, ease, and liquidity of stock trading to the benefits of traditional index fund investing.

To better understand ETFs, it may be helpful to understand index funds, which share some similarities.

## Both ETFs and Index Funds:

- Allow you to buy an interest in an entire portfolio of securities by purchasing a single security
- Are passively managed and have limited expenses
- Are designed to track the performance of an unmanaged index
- Track a broad market index or target a specific sector or segment of the market
- Track markets in various regions or countries

## Key Differences Between ETFs and Index Funds

ETFs	Index Funds
Shares can be bought and sold at intra-day market prices on an exchange. If permitted by your broker, shares on the secondary market can be bought on margin or by limit order, and may be sold short subject to exchange rules.	Shares can be bought and sold directly from the fund at a net asset value set once per day, typically at 4 p.m. ET. Index funds generally cannot be sold short or bought on margin.
Generally have lower expenses than traditional mutual funds (even index funds) and may have some tax efficiencies at the fund level.	Tend to have lower expenses than traditional mutual funds.
When buying shares in the secondary market, there are no investment minimums (i.e., you can purchase a single share) or sales charges other than the cost of a stock transaction.	Investment minimums can vary by fund, and fund shares can be either load or no-load.
Rapid trading in the secondary market by other investors does not create costs for other shareholders, and since the price is	Rapid trading by other investors can create costs for other shareholders since the fund manager must have cash on hand (or sell

set throughout the day by the market, there is no opportunity for late trading.

Shares are not individually redeemable from the fund. Instead they must be sold on the secondary market.

Shares are sold on the secondary market at market value, which may be less than NAV. There are no sales loads, however, transactions on the secondary market are subject to brokerage commissions.

shares of securities to generate cash) to satisfy redemptions.

Shares are individually redeemable from the fund.

Shares are redeemed at NAV.

### **Which Is Right for You?**

Generally speaking, if you are a long-term investor making smaller, periodic investments, you may want to consider traditional index funds over ETFs, because index funds can be purchased with no transaction commissions.

If you have longer time horizons and larger, lump-sum amounts, you may want to consider ETFs over index funds if you are investing in a taxable account. ETFs tend to generate fewer capital gains than mutual funds due to the low turnover of the securities that comprise them, and because they are not required to sell securities to meet investor cash redemptions. Keep in mind, however, that you will generate taxable capital gains/losses if you sell the ETF shares.