Understanding Exchange-Traded Funds

A man and a woman stand in front of a blackboard-like screen with Exchange-Traded Funds written on it.

Woman: “Exchange-traded funds. You’ve heard the name, or at least their initials -- ETFs. But you may not know what they are or how they might work in your portfolio.”

Man: “In their current form, ETFs have been around only since 1993. But they’ve attracted a growing number of investors.”

Woman: “These investors recognize the unique benefits of ETFs.”

Man: “Such as low management costs and a ready market for buying and selling shares.”

Woman: “Like mutual funds, ETFs invest in diversified baskets of securities. Some ETFs cover an entire asset class, such as stocks or bonds. Others focus on particular styles of asset selection, such as growth or value.”

Man: “But ETFs and mutual funds differ in some very important ways.”

Accompanying the narration are images of stock price quotations, a stock exchange trading floor, and financial charts. The words Active Funds and Passive Funds appear at the top of the screen. Key features of passive funds (Track a Benchmark Index and Lower Cost) and active funds (Actively Managed and Higher Cost) appear beneath. **Narrator:** “Shares in an exchange-traded fund can be bought or sold throughout the day, based on whatever the current market value of its holdings might be at the time of the trade. In contrast, a mutual fund’s shares are traded only at the end of the business day, based on the closing market value of the fund’s holdings. While most mutual funds are actively managed, most ETFs are passively managed. Passive funds buy and sell securities to match the composition of a chosen benchmark index, such as the S&P 500. Active funds, by contrast, tend to modify their holdings more frequently. Passive management tends to be significantly less costly than active management. In fact, the expense ratio for a passively managed ETF may be half that of an actively managed fund. Assuming they each perform the same, the passive fund could realize significantly higher net returns over time.”

The man and woman reappear.

Man: “As you can see, with their relatively low management costs and trading flexibility, ETFs can be a valuable part of your portfolio.”

Woman: “Talk to a professional today to find out whether investing in ETFs may be right for you.”