

Exchange Traded Fund (ETF)

What are they?

Exchange Traded Funds (ETFs) are pooled investments that have a trust-originated or open-ended structure. ETFs allow investors to diversify their portfolios by investing in a single unit or depositary receipt that conveys beneficial ownership in a basket of stocks or index representing a particular industry, sector, or group. When compared to traditional mutual funds, ETFs generally have lower operating expenses, the ability to be traded intra-day, and the ability to minimize capital-gains distribution.

ETFs are actively traded in several stock exchanges, most notably the American Stock Exchange (AMEX). On the secondary market, ETFs will trade with regular stock commissions and usually have a minimum investment amount of 100 shares.

When might an Investment Advisor consider ETFs for his or her clients?

ETFs should be considered by investors who seek to invest in an industry sector or index and don't want to acquire and manage a multitude of equity stocks in their portfolio. Investors with longer time horizons can benefit from the low expense ratios and management fees incurred by ETFs. Index-oriented investors can also use ETFs as an easy and cost effective means of rebalancing their portfolio towards a specific sector or country and facilitate tax-based trading strategies.

What are the Investment Benefits?

Diversification - ETFs are designed to provide a single investment value for the aggregate performance of a number of companies representing specific industries or market sectors.

Liquidity - Because ETFs are exchange-traded, they are continually priced and can be traded intra-day. They enable investors to easily rebalance their portfolio at a low cost or to take advantage of a market trend.

Low Cost - ETFs generally do not have a manager or analyst actively managing the portfolio, thus the turnover of the portfolio is limited to changes in the underlying index or corporate action in the underlying stocks. Because of the low turnover and passive management, ETFs have comparatively low expense ratios and management fees.

Trading Strategies - Similar to stocks, ETFs can be traded long, short (without subject to the Uptick Rule), and on margin.

Tax - The legal design of ETFs provides them with an ability to avoid distributing capital gains to investors not trading their shares.

What are some of the Investment Risks?

Market Risk - Because ETFs are based on an underlying basket of stocks or an index, they are subject to the same market fluctuations as these types of securities in volatile market swings.

Commissions - Investors purchasing ETFs in the secondary market are subject to regular stock commissions.

Market Price - ETFs (like exchange-traded products) can trade at a premium or discount from its net asset value (NAV). Therefore, the ETFs' price might not reflect its true value.

What are the different types of ETFs available through Schwab?

New Issue

HOLDRs - Holding Company Depositary Receipts (exchange symbol varies with sector): depositary receipts issued by Merrill Lynch through the HOLDRs Trust representing individual and undivided ownership interest in the common stock of companies involved in a specific segment of a particular industry.

Continuously Traded

QQQ - the Nasdaq-100 Trust Series I (exchange symbol: QQQ): a pooled investment designed to provide investment results that generally correspond to the price and yield performance of the Nasdaq-100 Index®.

DIA - DIAMONDS Trust Series I (exchange symbol: DIA): a pooled investment designed to provide investment results that generally correspond to the price and yield performance, before fees and expenses, of the Dow Jones Industrial Average ("DJIA").

SPDRs® - broad-based SPDR Trust Series securities (exchange symbols: SPY and MDY): pooled investments designed to provide investment results that generally correspond to the price and yield performance, before fees and expenses, of the S&P 500® Index and the MidCap S&P 400 Index respectively. There are also 9 Select Sector SPDR® Funds corresponding to specific Select Sector Indices.

FFF - the FORTUNE 500® Index Tracking Stock (exchange symbol: FFF): seeks investment results that correspond to the price and yield performance, before fees and expenses, of the FORTUNE 500® Index.

iSHARES - pooled-securities with an open-ended investment structure issued by Barclays Global Investors. There are over 50 different iShares index funds that trade like stocks on the AMEX, NYSE, and CBOE. Each share of the index fund represents a portfolio of stocks designed to closely track the world's most followed exchanges, markets, sectors, and indices. For more information, go to www.ishares.com.