

Exchange Traded Funds (ETF)

Frequently Asked Questions

Q: What is an ETF?

A: An exchange-traded fund, or ETF, is an investment product representing a basket of securities that track an index such as the Standard & Poor's 500 Index. ETFs, which are available to individual investors only through brokers and advisers, trade like stocks on an exchange.

Q: How does an ETF differ from an index mutual fund?

A: Index mutual funds also track baskets of securities. Unlike index funds, which are priced once after the end of each trading session, ETF prices change throughout the day because they're traded like shares. Like shares, they can also be sold short -- a bet that the index value will decline -- and bought on margin using borrowed money.

Q: What are the advantages and disadvantages of ETFs versus mutual funds?

A: Exchange-traded funds charge lower fees than actively managed mutual funds and offer investors a wide range of sectors, geographies and strategies. Investors in ETFs pay average annual expenses of \$25 for every \$10,000 of assets, compared with \$91 for actively managed U.S. stock funds, according to Morningstar Inc. in Chicago. Investors pay a brokerage fee when they buy or sell ETFs, a drawback for active traders. Commissions can range from as little as zero for certain customers to \$25 a trade.

Q: How do investors use ETFs?

A: ETFs are popular among institutional investors to make rapid and large bets on sectors such as oil, gold, waste-management and semiconductors. They also use ETFs to hedge their bets on stocks, bonds, commodities and other securities. In 2007, managers introduced ETFs for use in retirement accounts such as 401(k) plans, as well as life-cycle ETFs, which invest more conservatively as investors near retirement. For individual investors, ETFs offer a wider selection of indexes than mutual funds.

Q: What are actively managed ETFs?

A: In 2008, managers including Invesco Plc and Barclays were the first to receive approval from the U.S. Securities and Exchange Commission for actively managed ETFs. The active ETFs are designed to trade on an exchange like stocks, while investing in securities picked by a portfolio manager or by mathematical models.

Q: How much is invested in ETFs?

A: Assets in exchange-traded funds surged more than sixfold in the past 5 years to \$608 billion as of Dec. 31, 2007, according to Washington-based trade group Investment Company Institute. ETF assets will probably rise to \$1.4 trillion by 2011, according to estimates by Financial Research Corp. of Boston.

Q: Who are the major sellers of ETFs?

A: Barclays Global Investors, the asset-management unit of Barclays Plc in London, is the biggest seller of exchange-traded funds, with a 55 percent share of U.S. ETF assets as of Feb. 29, 2008, according to State Street Corp., which tracks ETF flows. Barclays manages about \$306 billion in ETF assets. State Street, based in Boston, is the second biggest seller of ETFs, with about \$130 billion in such assets.

Q: What are some of the biggest ETFs?

A: The three biggest exchange-traded funds as of Feb. 29, 2008, were the \$66 billion S&P 500 SPDR, managed by State Street, the \$46 billion iShares MSCI EAFE and the \$26 billion iShares MSCI EM, both managed by Barclays, according to data compiled by State Street.