An Introduction to Exchange-Traded Funds (ETFs)

What is an Exchange Traded Fund (ETF)?

An **ETF** (Exchange-Traded Fund) is a type of investment fund that is traded on stock exchanges, similar to individual stocks. ETFs may hold a collection of assets such as stocks, bonds, commodities, or a mix of asset types. Fully transparent active ETFs have emerged in recent years, providing access to more refined investment strategies than found with indexed, or passive, ETFs that are designed to track the performance of an index, sector, commodity, or other asset category.

Key features of Active ETFs include:

- **Access.** Active ETFs provide access to specialized strategies, with distinguished return potential and risk management, unlike the more constrained passive index ETFs.
- **Diversification.** ETFs provide exposure to a broad range of assets in a single investment, in an effort to reduce risk by holding multiple securities (e.g., stocks, bonds) within one fund.
- **Liquidity.** ETFs can be bought and sold throughout the trading day on stock exchanges, providing investors with flexibility and real-time pricing, similar to individual stocks.
- **Tax Efficiency.** ETFs are generally tax-efficient because of their "in-kind" creation and redemption process, which minimizes the need to sell underlying assets and trigger capital gains taxes.
- **Transparency.** Fully transparent ETFs are regulatorily required to disclose daily their complete set of holdings.

How do ETFs compare to mutual funds?

ETFs and mutual funds are both popular vehicles for diversifying investments by pooling money into a wide array of assets. However, ETFs provide intraday trading on stock exchanges with typically lower costs and better tax efficiency, while mutual funds are bought or sold at the end of the day. Both can be actively or passively managed, but their structures impact how investors use and potentially benefit from them:

- **Tax Efficiency:** ETFs are generally more tax-efficient because of their "in-kind" creation and redemption process, which minimizes the need to sell underlying assets and trigger capital gains taxes. Mutual funds may generate more capital gains, resulting in higher taxes for investors, especially in actively managed funds.
- **Minimum Investment:** Investors can buy ETFs with as little as the cost of a single share, providing greater flexibility in the amount they choose to invest. In contrast, mutual funds often have higher minimum investment requirements, limiting accessibility for smaller investors.
- **Transparency:** ETFs provide daily disclosures of their holdings, allowing investors to know exactly what assets they are invested in. Mutual funds, however, generally only disclose their holdings monthly or quarterly, sometimes with a delay.
- **Liquidity:** ETFs provide real-time pricing and can be traded throughout the day during market hours, providing greater liquidity for investors. Mutual funds, in contrast, are only priced and traded once per day after the market closes.
- **Flexibility:** ETFs provide investors access to trade throughout the day, and to employ limit orders or stop-loss orders to facilitate purchasing ETF shares at or near net asset value. Mutual funds, being bought and held until the end of the day for NAV, restrict flexibility sought by active traders.

Key features of Active ETFs include:

	ETFs	Mutual Funds	SMAs (Separately Managed Accounts)	Interval Funds	Closed-End Funds
Access to Private Investments	Yes, currently only through allocations to underlying closed-end funds	Yes, currently only through allocations to underlying closed-end funds	Yes	Yes	Yes
Offering Structure	Continuous	Continuous	Customizable	Continuous	IPO, then trades
Liquidity	Intraday	Daily	Customizable	Quarterly	Market
Transparency	Daily	Monthly/ Quarterly	Monthly/ Quarterly	Monthly/ Quarterly/	Monthly/ Quarterly
				Semi Annually	
Yield Potential	Moderate	Moderate	Customizable	High	High
Regulatory Oversight	Yes ('40 Act)	Yes ('40 Act)	Yes (varies)	Yes ('40 Act)	Yes ('40 Act)
Management Fees	Varies	Varies	Varies	Premium	Moderate
Investor Accessibility	Broad	Broad	Accredited (for private strategies)	Broad	Broad

Risk Disclosures

All investments involve the risk of loss of principal.

A **separately managed account** (SMA) is a portfolio of securities that is managed by a professional investment firm.

An **interval fund** is a pooled investment vehicle that offers investors periodic liquidity at an interval specified in its prospectus.

A **closed end fund** is a pooled investment vehicle that issues a fixed number of shares through an initial public offering. Its shares can be bought and sold on a stock exchange but it cannot issue new shares.

Active management is an investment management approach in which an investor, a professional money manager or a team of professionals tracks the performance of an investment portfolio and makes buy, hold and sell decisions about the assets in it.

Passive management is an investment management approach that seeks to mirror the performance of a designated index.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

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