

FINANCIAL CAREER FEATURE



ETFs gaining popularity as investment vehicles

[By Shaileja Mammen]

The number of the Exchange Traded Funds (ETFs) has grown exponentially during 2006. ETFs provide a wide range of investment opportunities across asset classes, industry sectors, management styles, and international boundaries—including emerging global markets like India, China, Brazil, and many others. They provide a wide range of choices to create a portfolio which is tax-efficient, cost-effective, and easy to implement. At the same time, the wide range of choices can confuse investors.

Exchange Traded Funds are securities that provide the right of ownership of a basket of predecided individual stocks or other asset classes. ETFs give the investors the opportunity to buy or sell an entire portfolio of stocks in a single security.

Investing in ETFs is the cheapest and the easiest way to invest in any asset class.

There are ETFs for large companies, small companies, international stocks, fixed-income securities like bonds, commodities such as gold and silver, different indices, real estate, industry sectors, and many more.

ETFs overcome the drawbacks of index funds and stocks. Like index funds, ETFs are constructed to track benchmarks. Besides, ETFs have low turnover and low expense ratios, and they can be traded on the exchange. Taking short positions and buying with margins is also possible with ETFs. They can be bought and sold through brokerage firms.

Some of the advantages of ETFs are:

- They track a sector or an index but can be bought and sold on the stock exchanges like any other stock.
- They are representative of a basket of stock or assets and thus are diversified, unlike a single stock.

- The transaction costs are lower than those of mutual funds. If mutual funds are bought and sold very frequently, the cost escalates substantially because fees are charged for holding for less than six months. In the case of ETFs, the brokerage fee is lower.
- ETFs can be bought and sold all through the day, unlike mutual funds, which can be bought or sold only at the closing NAV every day. The underlying assets of an ETF are known to the investor, while in case of a mutual fund they may change and only the top holdings are disclosed.
- ETFs can be sold short and bought on margin.
- ETFs are tax efficient, as turnover is low as compared to actively managed funds.

Barclays Global Investors (BGI) was the first to bring out ETFs in the market. Today, BGI alone has more than 100 ETFs, called iShares, which are listed on the Stock Exchange. Some of the other ETF providers are State Street Global Advisors; Standard & Poor's Depository Receipts (SPDRs); Vanguard Exchange

Traded Funds; Healthcare Shares, Inc.; PowerShares Capital Management, LLC; Merrill Lynch HOLDERS; Fidelity Investments; Deutsche Bank; First Trust Portfolios; and WisdomTree.

There are over 200 ETFs issued by more than 15 institutions which are listed on the American Stock Exchange. The international ETFs during the last three years have outperformed the domestic ETFs. This is also one of the reasons for the popularity of the ETFs.

The performance and proliferation of ETFs indicate the popularity of ETFs. They seem to be an ideal investment vehicle, but some issues have been raised in recent times about the proposed actively traded ETFs. There are proposals filed with the Securities and Exchange Commission (SEC) to introduce actively managed ETFs to the market.

Debate is raging over the pros and cons of ETFs, though actively managed ETFs are already viable in Germany and Australia. Their precedent may encourage American acceptance.

Some of the concerns about actively managed ETFs are regarding their performance, cost effectiveness, transparency and daily disclosure of holdings, tax advantage, investors' interest, and regulatory compliance.

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In short, the advantages of ETFs listed above may no longer exist if the complexity of the sector increases.

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en.wikipedia.org/wiki/Exchange-traded_fund

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