ETFs have revolutionized investing. Their phenomenal growth has afforded investors new opportunities to gain precise exposure to an array of asset classes, from sectors and industries to emerging markets and commodities. Learn how these instruments can transform your business.

What are ETFs?
ETFs combine the benefits of other investment vehicles — like the diversification of index mutual funds and the real-time liquidity of stocks. This formula allows for the unique way that ETFs are created and redeemed.

Comparing ETFs to Index Mutual Funds and Individual Stocks

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>ETFs</th>
<th>Index Mutual Funds</th>
<th>Individual Stocks</th>
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</thead>
<tbody>
<tr>
<td>Pricing</td>
<td>ETFs trade all day long at their market price, just like stocks. Investors buy and sell shares continuously throughout the day. Captures the precise movement of market at time of purchase/sale.</td>
<td>Mutual funds are priced at the end of the trading day. Shareholders purchase and redeem shares at the closing value of the fund. The price or net asset value (NAV) is the value of the fund’s assets, less liabilities, divided by the total number of shares outstanding. The closing value of mutual fund shares is calculated at the end of the trading day.</td>
<td>Market price, capturing the precise movement of the market at time of purchase/sale.</td>
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<tr>
<td>Tax Consequences</td>
<td>The investor decides when to sell ETF shares, and any associated capital gains tax is paid at the time of final sale, offering greater control on the timing of tax consequences.</td>
<td>The investor decides when to sell a mutual fund share. To deliver cash in the amount of an investor’s position, the fund may sell a portion of a fund’s security holdings, which may generate a realized taxable gain. Taxes on those gains are absorbed by all shareholders in the fund.</td>
<td>The investor decides when to sell a stock, and any associated capital gains tax is paid at the time of final sale, offering greater control on the timing of tax consequences.</td>
</tr>
<tr>
<td>Fees and Expenses</td>
<td>The average expense ratio for index ETFs is lower than that of index mutual funds. ETFs historically have had a lower average expense ratio — 0.58%.</td>
<td>Mutual funds historically have had a higher average expense ratio — 0.94%.</td>
<td>Individual stocks do not have an expense ratio.</td>
</tr>
<tr>
<td>Minimum Investment</td>
<td>With ETFs, there is no minimum investment requirement. An investor can purchase as few as one ETF share or as many as is preferred.</td>
<td>Mutual funds may require investment minimums of $2,500 or more.</td>
<td>Individual stocks do not require a minimum investment.</td>
</tr>
</tbody>
</table>

1 However, changes in an ETF’s underlying index could trigger the sale of securities which, in addition to transaction costs, may trigger capital gains distributions. In this scenario, any realized gains or losses are passed on to ETF shareholders. To ensure tax efficiency, ETF managers attempt to limit these types of transactions as much as possible.

2 Morningstar Direct. Data as of 3/31/2016. Average Prospectus Net Expense ratio for index ETFs and open end Index mutual funds as defined by Morningstar.

3 Subject to brokerage rules/costs/fees.

4 There are mutual funds that do not require investment minimums.
A Guide for Advisors

Potential Benefits of ETFs
ETFs may offer a unique set of benefits.

Transparency
Generally with ETFs, the securities held within it are known. As portfolio compositions are posted daily, there is no need to wait for the end of the quarter to review the fund’s holdings.

Why does this matter? Investors have all the information needed to make informed investments — holdings are fully disclosed so investors understand their investments.

Lower Expense Ratios
Due to low turnover of most ETFs and the indexes they track, transaction costs are minimized.

Why does this matter? Investors keep more of their returns when costs are low. Due to their passive nature and structure, ETF costs are generally low. Frequent trading of ETFs could significantly increase commissions and other costs such that they could potentially offset any savings from low fees or costs.

Liquidity
ETFs may be used to quickly capitalize on investor convictions regarding the performance of particular market segments.

Why does this matter? At liquidation, the value of an ETF may be worth more or less than the principal invested. While the shares of ETFs are tradable on secondary markets, they may not readily trade in all market conditions and may trade at significant discounts in periods of market stress.

Tax Benefits
ETFs are built to be tax efficient because they are index investments. Unlike mutual funds, individual ETF investors typically do not bear the burden of capital gains taxes resulting from another investor’s buying and selling.

Why does this matter? Investors control when they incur most taxes. Because ETFs track market indexes, turnover is generally low.

Typically, lower turnover results in fewer capital gains and thus lower taxes. Investors typically don’t realize capital gains from other shareholder redemptions.

Diversification
ETFs spread investment dollars across many individual securities, rather than putting all dollars into one single security.

Why does this matter? Investors have precise control over their investment strategy through exposure to broad markets as well as targeted access to asset classes such as sectors and industries. However, diversification does not ensure a profit or guarantee against loss.

Trading Flexibility
ETF shares can be bought and sold through a brokerage account, the same as stocks. ETF shares can be bought and sold at their current market price anytime during the trading day.

Why does this matter? Since ETFs can be traded intraday, they can be bought and sold in response to market movements. Additionally, unlike many mutual funds, there are no minimum holding periods for ETFs. Also because they trade intraday, ETFs can be bought long or sold short.

Incorporating ETFs into Portfolios
Incorporating ETFs into client portfolios starts with a question: ‘What does the client need?’ Like a craftsman uses a specific tool for each task, savvy investment professionals use different strategies with ETFs to efficiently construct client portfolios.

Asset Allocation
ETFs offer investors a sophisticated tool to gain exposure to broad and targeted market segments covering a wide range of asset classes, equity market capitalizations, styles and sectors. This enables investors to build customized investment portfolios consistent with their financial needs, risk tolerance, and investment horizon. Asset Allocation does not, however, guarantee a profit or protect against loss.

Risk Management
The broad array of ETFs available today creates risk management approaches for individuals and smaller institutions that only large institutional investors could access previously. Also, the smaller denominations in which ETFs trade relative to most derivative contracts provide an accurate risk exposure match for portfolios of any size. Furthermore, in the US, ETFs can be shorted on a down-tick, providing greater trading flexibility. The increasing use of incentive stock options has also created a growing segment of affluent investors with unique risk management needs. By using sector ETFs, these investors can hedge their concentrated exposure to the companies they own in an attempt to effectively diversify their risk exposure across the broader equity market.
**Portfolio Management**
ETFs can provide an easy means to refine portfolio strategy and adjust a portfolio in response to market shifts or client sentiment/needs. Due to their inherent benefits, ETFs provide investment professionals with an easy tool for portfolio rebalancing.

Year end provides an apt opportunity to rebalance portfolios while taking advantage of possible unrealized losses. Working with your clients to identify long-term strategic asset allocation targets is key to this approach. Treat this process as an opportunity to have a larger discussion about your client’s risk tolerance and how it may be changing as time goes on.

**Transition Management**
When investors change asset managers, they are often concerned with how to preserve equity exposure during the transition. One way to achieve this goal is to liquidate the portfolio and re-invest the assets in an ETF with a high correlation to the benchmark of the active manager. Once a new manager is chosen, the investment professional can sell the ETF shares to fund the purchase of this exposure.

**Learn More**
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