Seeking Alpha α

25 Things Every Financial Advisor Needs To Know About ETFs

by: Michael Johnston

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The rapid expansion of the ETF industry has been one of the most important developments of the last several decades to financial professionals; as the lineup of exchange-traded products has surged past 1,300, financial advisors now have more tools in their toolkits than ever before to help construct client portfolios. With these new financial products comes a responsibility to understand the various risk factors and nuances of exchange-traded products, and as the industry has expanded rapidly the amount of information to digest has swelled as well. While ETF education must be an ongoing process, there are a number of basics that can enhance overall understanding, identify opportunities and limitations, and generally promote a better experience with ETFs:

1. Volume ≠Liquidity

Many advisors and investors like to implement what can best be described as "liquidity screens," refusing to consider products that don't have a certain average daily trading volume (25,000 shares daily is a common rule of thumb). That could be a big mistake, as this approach results in overlooking hundreds of smaller products that may offer compelling investment theses and unique exposure.

The historical volume of an ETF tells very little about how liquid a fund is, because ETFs are capable of something called "spontaneous liquidity." Because there is a mechanism in place that allows for the creation of new shares almost immediately, it is possible to execute large trades in thinly-traded funds without moving the price by a meaningful amount.

It's been noted that ETFs trade like stocks–which is part of the appeal of the exchange-traded structure. But there are limits to that comparison; if you know what you're doing (more on this below), it's possible to buy 1 million shares of an ETF that trades 10,000 shares daily within a few basis points of NAV. That might sound hard to believe, but it's absolutely true–and part of the beauty of ETFs.

A quick call to any ETF issuer will get you speedy assistance on the execution side; alternatively, there are firms such as WallachBeth that can provide smooth execution of block trades for a minimal fee.

2. Market Orders Just Might Burn You

It should be noted, however, that achieving a desired level of liquidity in an ETF often requires a bit of work and diligence. Advisors accustomed to the execution of positions in mutual funds should be aware that ETFs work in an entirely different manner. Instead of buying from and selling directly to the fund company, ETFs are often sold between market participants. And there is no guarantee that trades will be executed at or near NAV; rather, shares change hands at whatever price clears the markets.

Low volume ETFs should not be avoided due to liquidity-related fears. But low average daily trading volumes should result in additional caution being paid when buying or selling a fund for a client portfolio. Wide bid-ask spreads can result in additional fees incurred, and put clients in an early hole.

Fortunately, the tools for avoiding such pitfalls are both cheap and easy to use; limit orders can be tremendously powerful mechanisms for investors.

3. Not All ETF Expense Ratios Are Created Equal

Some advisors making the switch from mutual funds to ETFs have a tendency to pat themselves on the back for embracing low cost strategies that will make their clients money over the long run. The assumption that all ETFs are created equal, however, is utterly false. The reality is that the gaps between funds offering similar (or nearly identical) exposure can be drastically different.

The best example is probably a comparison of the iShares MSCI Emerging Markets Index Fund (EEM) and the Vanguard MSCI Emerging Markets ETF (VWO). Both funds are linked to the MSCI Emerging Markets Index, yet EEM (0.69%) costs nearly 50 basis points more than VWO (just 0.22%). There are a number of other examples of similar product with huge gaps in expenses, and the impact over the long run can be significant.

If you're serious about minimizing fees, it pays to shop around: not all ETFs are created equal in terms of cost efficiency.

4. Bigger Does Not Equal Better

When evaluating potential ETF options, there is a tendency among some advisors to gravitate towards the products that have the largest asset base and most substantial average daily volume, or to pick out only funds from well-known issuers such as iShares and Vanguard. Many of the largest exchange-traded products are popular for a reason; they offer cheap, efficient access to desirable asset classes. But in many instances, the size of an ETF is more indicative of the length of its operating history than the attractiveness of the underlying portfolio and methodology to long-term investors. Innovation in the ETF space has gradually refined the type of exposure offered, and many of the newer, smaller products solve some of the issues that plagued the first generation of ETFs.

The FTSE China 25 Index Fund (FXI) is a great example. That fund is by far the most popular China ETF on the market with more than $6 billion in assets. But for investors seeking long-term exposure to the Chinese economy, it's pretty safe to say that there are better choices available. FXI's portfolio is both shallow (25 stocks in total) and extremely unbalanced; financials account for the majority of exposure, while consumer, tech, and health care stocks get little or no weighting.

Don't assume that a hefty asset base is the only indication of the efficiency of an ETF. More often than not, digging beyond the most popular product in a category will uncover some hidden gems in the space.

5. There's More To ETF Expenses Than Expense Ratios

It should also be noted that expense ratios do not tell the entire story when it comes to ETF expenses; there are other components that must be considered when determining the total cost of an ETF investment.

Commissions are one area in which a little effort can go a long way; in recent years various brokerages have rolled out programs that include commission free trading on popular funds in an effort to attract investors who value and use ETFs frequently. Paying $7 or $10 to execute a trade perhaps doesn't seem like much, and for larger portfolios with minimal turnover the impact of trading commissions may be minimal. But for smaller accounts, fees can add up quickly, potentially equaling the basis point contribution of expense ratios.

Bid-ask spreads should also be considered when evaluating an ETF; buying at a premium or selling at a discount has the same impact on bottom line returns as a higher expense ratio.

6. Structure Matters

The term "ETF" is often used incorrectly to include products that are not technically exchange-traded funds. More accurately, the ETP umbrella can be described as covering a number of types of exchange-traded products, including ETFs, exchange-traded notes (ETNs), unit investment trusts (UITs), grantor trusts, and others. From the perspective of most investors, these slightly different structures are generally similar; each offers transparent, liquid access to an underlying basket of securities.

In some instances, however, structure matters. ETFs and ETNs may be similar in many respects, but they are very different in others. And the differences are not limited to credit risk and tracking error; in certain asset classes, such as commodities or MLPs, the choice of structure can end up having a huge impact on tax consequences and bottom line returns and volatility. Using the head-to-head ETF comparison tool to analyze AMLP and MLPI illustrates this point quite nicely. Though AMLP (an ETF) and MLPI (an ETN) are linked to the same index, the performances are clearly not identical.

There are a number of other examples of structure impacting the risk/return profile achieved by an exchange-traded product. SPY, a UIT, will perform differently than IVV, which is also linked to the S&P 500 but structured as an ETF. The three ETPs that offer exposure to the USD / EUR exchange rate maintain unique tax consequences and counterparty risk, and annual performance can vary by more than 100 basis points depending on the environment.

7. Commodity ETFs Get A Bad Rap

Commodity ETFs have been dragged through the mud repeatedly over the last several years, the result primarily of misunderstandings (or perhaps outright ignorance) over the true objectives and limitations of these products. Specifically, the "tracking error" between the returns generated by commodity ETPs and the change in the spot price of the related resource. While it's true that most commodity ETFs deliver returns that differ from a hypothetical return on spot prices–sometimes by a significant margin–that deviation isn't the result of a flaw in these products. Rather, it reflects confusion over exactly what these products seek to achieve and the methods they use to achieve their results.
It's important to exercise caution when investing in commodity ETPs; if you don't have a firm grasp on the nuances of a futures-based strategy, you probably have no business putting these products in your clients' portfolios. But for those who understand what's under the hood of these funds and the potential limitations associated with the methodology used to achieve exposure, commodity ETFs can be very powerful tools that can bring both return enhancement and diversification benefits to traditional stock-and-bond portfolios.

Commodity ETPs aren't for everyone. But they certainly aren't the flawed, return-eroding vehicles that some have made them out to be.

8. Diversification Should Not Be An Assumption

ETFs, like mutual funds before them, have become popular among investors with a long-term focus because they can be used to achieve cheap and easy diversification. Many ETFs include hundreds or even thousands of individual securities, allowing for broad-based exposure that would be prohibitively expensive and time consuming to establish otherwise.

But not all ETFs offer tremendous diversification. Some, in fact, are quite concentrated in a small number of individual stocks or in a few select sectors. It isn't all that uncommon for a product to allocate 20% or more to a single holding, or for a single sector (often financials) to make up 50% of a fund's portfolio. Diversification across companies and sectors is generally the rule, but there are plenty of exceptions.

One of the oft-cited advantages of ETFs is the transparency; investors can see exactly what a fund holds in close to real time. Take advantage of that feature; be sure to know what a product holds before establishing a position.

9. ETFs Can Close…

The ETF industry can be described as both extremely deep and extremely top-heavy. There are more than 1,300 products out there, but about 25 of those account for nearly half of total assets. Close to half of the funds now trading have less than $25 million in AUM–a rule of thumb for the level of assets required to break even. The economics of an industry built around bargain basement expense ratios can be challenging to issuers. It costs money to run an ETF, and a significant portion of the products out there now are losing money. Many of those cash drains are young products that are still establishing a track record and attracting assets. Some will grow into products with hundreds of millions in assets that generate profits for the issuers while still offering low expenses to investors.

But some will not, and they will ultimately be shut down. There are three certainties in life: death, taxes, and the fact that several ETFs will close down in coming years. That's something that advisors should acknowledge, but it shouldn't necessarily scare you off. An ETF closing is not cause for panic; you'll have the opportunity to either sell your shares prior to the delisting or to receive your share of cash proceeds. That may be less than optimal; the sale may trigger some tax liabilities, and there are costs associated with redeploying capital. But overall, an ETF closure isn't really a big deal; your clients will get their capital back, and the hunt for a suitable alternative will begin [see How To Deal With ETF Closures].

10. …And ETNs Can Fail

ETNs have become popular tools for accessing certain asset classes; this structure has several potential tax advantages as a way to access commodities, MLPs, and other strategies. The ETN structure allows for the avoidance of tracking error, a deviation from the performance of an index that can erode returns–especially to futures-based strategies. But there are some risks to ETNs as well. These securities are senior, unsecured debt instruments issued by financial institutions, and as such are subject to the same risk factors as more traditional forms of debt. If an ETF issuer goes out of business, investors in that company's funds will have their capital returned. If an ETN issuer goes under, the consequences can be much more severe; investors in those products are creditors to the bank, and as such will likely find themselves in line with other counterparties owed money by a bankrupt institution.

The risk of an ETN leaving investors holding the bag may seem pretty remote; the issuers of these notes are often large, well capitalized banks such as Credit Suisse, UBS, and Barclays. And even in a less-than-stellar economic environment,

the possibility of one of these firms going belly up is minimal. But the collapse of an ETN issuer wouldn't be without precedent; Lehman Brothers offered a lineup of exchange-traded notes prior to its sudden bankruptcy [see ETF Hall Of Shame].

11. There's An ETF For That The first generation of exchange-traded products were generally "plain vanilla" funds linked to well-known stock and bond indexes, such as the S&P 500 or Russell 2000. But over the last several years, an impressive string of innovation in the industry has resulted in a product lineup full of very specialized and targeted products. Just about every major global economy is now covered by an exchange-traded fund–and in many cases there are multiple options available. Targeted sector funds are becoming increasingly common; from the smartphone ETF to business development company ETNs to funds focused on the automotive industry, getting granular is not a problem.
The ETF boom has democratized entire asset classes–the surge in usage of commodity ETFs and volatility ETPs is perhaps the best example of that phenomenon. Growth in the space has also opened up opportunities to achieve quick, easy exposure to an investment strategy; the investment discipline ETFs from Russell offer exposure to techniques such as aggressive growth, contrarian investing, and low P/E stock selection.

Whatever investment strategy or asset class you have in mind, chances are there's an ETF that lines up quite nicely. ETFs aren't just for buy-and-holders seeking plain vanilla exposure; they offer the ability to become extremely specialized and fine tune exposure desired.

12. Keep It Simple…

There are now more than 1,300 exchange-traded products, and the lineup is growing rapidly. While many of the most popular funds offer exposure to straightforward strategies covering key asset classes, there are hundreds of ETFs that utilize leverage, derivatives, and sophisticated techniques to tap into sophisticated strategies. A lot of the ETFs on the market have little or no use to the vast majority of investors; those looking to build a balanced, long-term, buy-and-hold portfolio realistically only care about a small fraction of the ETF universe.

Think of the ETF universe as a toolkit, and individual ETFs as the tools. The more tools at your disposal, the better. But certain tools are useful for some tasks and wildly inappropriate for others. A chainsaw is pretty darn useful if you're looking to cut down a tree. But when you're slicing a loaf of bread, that same tool can produce disastrous results.

The point is this: most ETFs out there are not useful for your clients' objectives. And that's just fine; just because a product is out there doesn't mean that it needs to be included in your portfolio. Here's a simple piece of advice when determining the suitability of a potential ETF investment: if you can't understand the components, strategy, and risk factors in five minutes, walk away.

13. …But Not Too Simple

One interesting development in the ETF industry includes "target retirement date" products that are designed to "glide" towards a retirement date in the future by gradually shifting towards bonds and away from stocks as clients are and presumably the risk / return profile shifts. For those looking to minimize complexity and maintenance requirements, target retirement date ETFs are about as simple as it gets. Theoretically, a client could hold a single ticker that automatically adjusts allocations to key asset classes as they age.

We suppose target retirement date ETFs might be useful for some. But the limitations and potential drawbacks of these products are numerous. First, there is the obvious point that time to retirement is only one factor that shapes a client's asset allocation process. Overall wealth, risk tolerance, and presence of income streams should also be considered.

Second, the allocations in some of these products seem to be disconnected from reality. Consider the iShares S&P Target Data 2050 Index Fund (TZY), presumably designed for investors with a fairly long time until retirement. Emerging markets, as represented through EEM, account for about 4.2% of total assets. Even acknowledging that U.S. investors tend to maintain a "home country bias" that results in underweighting emerging markets, that allocation seems woefully low.

Finally, there is the issue of expenses. Because target retirement date ETFs are structured as ETFs-of-ETFs, there are two layers of fees. In addition to the management fee on the fund (TZY charges 0.25%), each of the component products incurs expenses that push up the effective cost to your clients. For those in it for the long haul, the compounding of costs can eat into returns.

Odds are, it's best to stay away from target retirement date ETFs; take the time to customize exposure to your clients' portfolios, and they'll thank you later.

14. Watch Your Weight

When considering potential ETF investments for accessing domestic or international stock markets, most advisors probably give little or no thought to the weighting methodology employed by the underlying index. While that might seem like a minor impact that is unlikely to have much of an impact on returns, the reality is that the manner in which weightings are assigned to component stocks can translate into huge differentials in performance.

The majority of stock ETF assets are in products linked to market capitalization weighted indexes, based on a methodology that gives bigger weightings to more valuable companies. But in recent years the potential drawbacks of cap-weighting strategies have become more obvious, and the alternatives more readily available. There are now ETFs that assign weights to component stocks based on various "fundamental" factors, including sales, earnings, dividend, cash flow, estimated earnings, and even book value.

The impact of this seemingly minor nuance can be significant. The performance of the Rydex S&P Equal Weight ETF (RSP) and S&P 500 SPDR (SPY) in 2010 highlights this point nicely. The components of these two stocks are identical; both hold the 500 or so equities that make up the S&P 500. But RSP, which gives an equal weight to each, outperformed SPY in 2010 by about 600 basis points. For two products that have identical portfolios, that's a pretty significant gap.

If you've historically relied on cap-weighted products, there's a lot to learn about the alternatives. But it's a lesson well worth the effort; the result could be a relatively easy way to improve your clients' bottom line returns.

15. Contango Can Be A Killer (And Backwardation Can Be A Blessing)

A recurring theme here has been the importance of looking under the hood and knowing exactly what you are buying for your clients. That is particularly true in the commodity ETF space, a corner of the market that has exploded in recent years as investors have embraced the exchange-traded structure as a way to tap into an asset class with tremendous return enhancement and diversification potential.

It is important to understand that the vast majority of exchange-traded commodity products do not seek to deliver returns that correspond to movements in the price of the spot commodity. In most cases, that simply is not possible; the logistics of owning livestock or natural gas are obviously challenging. Rather, these funds offer access to a futures-based strategy that invests in securities linked to underlying commodities. While the correlation is strong, the performances are in no way identical; often, the gap between a futures-based product and the hypothetical return on spot is significant.

Commodity ETFs can be very powerful tools. But it's important to recognize their limitations. If you're expecting access to spot natural resources, you haven't done your homework, and could be setting clients up for a big disappointment [see How Contango Impacts ETFs].

16. There's More To ETFs Than Low Fees

When asked to explain the undeniable shift in the investing landscape from mutual funds to ETFs, most investors, journalists, and analysts will jump to one issue: expenses–or the lack thereof. The average expense ratio in the ETF universe comes in at about 59 basis points, and the weighted average is considerably lower than that (in the neighborhood of 0.33%). Some ETFs charge as little as five basis points, a fraction of the 1.4% or so that is the average among mutual funds.

So it's easy to see why expenses stand out as the primary driver of the river of cash flowing from mutual funds to ETFs. But it's worth noting that the lower expenses are just one of the value adds that the exchange-traded structure can bring to client portfolios. Relative to their mutual fund counterparts, exchange-traded products have a number of other advantages:

- **Liquidity:** ETFs can be traded like stocks, throughout the course of the day. That flexibility can come in handy when you're looking to be nimble and move a client quickly out of or in to a position. Instead of waiting until the end of the day, ETFs allow advisors to execute trades in a matter of seconds–a period of time that can translate into significant dollars in some cases.

- **Transparency:** The transparency of ETFs allows advisors to know what they hold in close to real time, instead of waiting for quarterly disclosure statements to see how significant your client's exposure to a particular security is. When stocks are tanking, it can help to know exactly what you hold–as anyone who has been forced to speculate on the degree of exposure to BAC or NFLX can attest.

- **Tax Efficiency:** The nuances of the creation / redemption mechanism generally result in superior tax efficiencies for ETFs, essentially allowing investors to control the timing of their obligations. For those who have become accustomed to being impacted by the redemptions of other fund investors, this efficiency might be a welcome change.

The low cost feature is just the tip of the iceberg; there are plenty of other reasons to make the switch from ETFs to

mutual funds.

17. ETFs Are Not An Acceptance Of Mediocrity

Some skeptics view ETFs as an acceptance of mediocrity, tools for simply running with the pack and giving up on any chance to generate alpha through stock picking or other active techniques. But that argument falls apart under even the most cursory of examinations. First, there is a boatload of academic evidence suggesting that active managers, on the whole, fail to beat their benchmarks after fees are considered. Sure, there are some superstars who top their index year in and year out. But unless you've found the next Peter Lynch, an attempt to generate alpha is more likely to destroy value than it is to create it.

Regardless of where you stand on the value of active management, it should be abundantly clear that "beta instruments" such as ETFs can most certainly be used in the pursuit of alpha. Again, the research suggests that asset allocation is responsible for a significant portion of portfolio returns. And ETFs are the perfect tool for tilting exposure towards certain assets and away from others without diving in to the weeds and racking up the fees to choose between various stocks. If you're looking to actively manage a client portfolio, there's no reason that ETFs can't be an integral, cost efficient part of that strategy.

18. ETFs Did Not Cause The Flash Crash

Another myth about ETFs is that these securities were the primary culprits behind the "Flash Crash," a chaotic day of trading that saw several securities–including a number of ETFs–lose and then recover billions of dollars in a matter of seconds. Because a disproportionate number of the securities impacted on that day were ETFs, rumors began to spread that these vehicles were somehow responsible. In reality, ETFs were simply swept up in the chaos, and were impacted heavily because of the breakdown in the creation/redemption mechanism that generally keeps prices and NAV closely aligned.

The details behind that day and the role that ETFs played in the chaos is enough to fill a novel; for those who want to dig a bit deeper into the weeds, there is plenty of well-reasoned analysis of exactly what happened that day, and the role ETFs played.

19. An ETF Cannot Collapse

To continue the myth-busting portion of this article, let's move on to another misconception that gained momentum earlier this year after the publication of research papers that purportedly detailed how certain exchange-traded products could collapse, leaving investors without the exposure they thought they had established. The notion that ETFs with significant short positions can potentially collapse centered around the idea that a wave of redemptions would eliminate all outstanding shares of the fund. But the reasoning behind the paper–which was picked up by several mainstream media outlets, presumably for the "shock" value–was flawed from the beginning.

The reason an ETF cannot collapse is pretty straightforward; redemptions require settled shares of an ETF, meaning that access to and control of the shares in question must be shown before a redemption can take place. The mechanics here get pretty complex; rather than delve into an extended analysis, we'll leave a few links that contain in-depth explanations and analysis of why ETFs–even those with huge net short positions–are in no danger of collapsing.

20. Bond ETFs Can Be Flawed

In recent years, more and more advisors have embraced exchange-traded funds as tools for establishing fixed income exposure, electing to access bonds through a structure that provides lower costs and enhanced transparency. While the marriage of fixed income and the exchange-traded structure has tremendous potential, there are a number of noteworthy factors that should be considered before going down this road. First, the cash flow experience of bond ETFs differs from holding an actual bond. The majority of bond ETFs, including popular funds such as AGG and BND, are designed to operate indefinitely. That means that proceeds from any bonds reaching maturity are reinvested in new securities. In most cases, the effective maturities of bond ETFs remains constant over time, meaning that interest rate risk will not decline as clients age. That isn't the end of the world for advisors, but it does mean that more diligent monitoring may be required with these products.

It should be noted that there are now a number of "target date" bond ETFs designed to more closely replicate the experience of holding actual bonds. These ETFs, including the BulletShares products from Guggenheim and muni bond funds from iShares, focus on debt issues maturing in a specific year. As the maturity dates approach, the ETF's portfolio shifts to cash, ultimately making a distribution to investors that represents the return of principal.

There are some additional factors that should be noted with respect to some popular bond ETFs. Some investors see products such as AGG and BND as one stop shops for fixed income exposure. But even thought these funds are in our

Total Bond Market ETFdb Category, there are some noteworthy omissions from the portfolio. AGG and BND are tilted heavily towards U.S. Treasuries, with zilch in the way of international bonds or junk bonds. While these ETFs can be valuable core holdings in a fixed income portfolio, there is much more to complete bond market exposure that isn't found in these funds.

21. ETFs Are A Vehicle (Not A Strategy) ETFs are generally associated with passive management, and held out as alternatives to actively-managed mutual funds. It's somewhat common to hear investors compare "ETFs vs. active management" or "mutual funds vs. indexing strategies." But it's important to keep in mind that ETFs are a vehicle that can be used to achieve exposure to passive index replication or active management, just as mutual funds can tap into either strategy.

22. Odds Are, You've Got Options

Once upon a time, accessing a strategy or asset class through exchange-traded products was a binary decision: you either did it, or you didn't. And while the surge in ETPs in recent years has primarily been the result of innovation, there's been a fair amount of duplication as well. The result: many asset classes and even indexes are now covered by multiple exchange-traded products. For example, there are three S&P 500 ETFs, five pharmaceutical ETPs, three funds offering exposure to the Australian stock market, and four bond ETFs that seek to replicate the Barclays Capital U.S. Aggregate Bond Index.

In other words, advisors likely have options among the ETF universe. And you would be wise to take advantage of the abundance of choice; combing through the various options targeting a specific sector or benchmark can lower fees, improve depth and balance of a portfolio, and optimize tax efficiency.

23. Nice Returns Can Come In Small Caps (Or Not)

ETFs have become popular as tools for establishing exposure to international stock markets, ranging from developed markets in Western Europe to emerging economies in Asia to frontier markets in Africa and beyond. And thanks to impressive innovation in the last several years, just about every major global economy is accessible through a pure play ETF.

But it is important to understand that most international stock ETFs–especially those that were launched in the early 2000s–are linked to cap-weighted indexes that tend to be dominated by the largest and most valuable companies in that market. That isn't necessarily a bad thing, but the tilt towards large caps can have a meaningful impact on the returns achieved.

Specifically, large cap-heavy ETFs are likely to include companies that may generate revenue around the world though headquartered in a single market. As an example, imagine Coca-Cola (KO): a U.S.-listed stock that derives the bulk of its revenues from overseas operations. While technically a U.S. stock, the company is perhaps more dependent on consumption patterns in China and India.

Small cap ETFs have become popular tools in recent years because they can represent more of a "pure play" on the local economy–a chance to get closer to the ground in international markets and invest in companies that stand to benefit from growth in the local market. And in many cases, these funds can exhibit returns that differ dramatically from their large cap counterparts. As an illustration, consider the performance of two Brazil ETFs last year: the large cap heavy EWZ and small cap focused BRF.

Ticker	ETF	2010 Gain
BRF	Brazil Small Cap ETF	7.7%
EWZ	MSCI Brazil Index Fund	24.1%

Both are Brazil ETFs, but these two products are clearly far from identical.

There are a number of small cap ETFs out there that offer international equity exposure, and in many cases these products may be a better fit for clients' portfolios than their large cap counterparts.

24. Sometimes, ETFs Aren't The Best Option

Don't get us wrong; the team at ETFdb includes some of the biggest ETF fans in the world. The tremendous growth of the industry in the last few years is a testament to the advantages inherent in the exchange-traded structure, ranging from lower costs to excellent transparency to intraday liquidity and improved tax efficiencies. In many cases, the exchange-traded

structure is simply a better mousetrap; it represents the optimal vehicle for accessing a wide variety of asset classes. But there are some cases where it might make sense to employ another strategy: ETFs are not always the most appropriate tool in the toolbox.

Though ETFs are generally cheaper than their mutual fund counterparts, that isn't always the case; some Vanguard mutual funds, for example, offer a total cost proposition–including management fees, transaction fees, and bid-ask spread considerations–that ETFs can't top.

Moreover, there may be some asset classes where investors are more comfortable with the expertise of an experienced management team, as opposed to subscribing to an indexing strategy that simply seeks to replicate a rules-based benchmark. Emerging market debt, for example, is one corner of the market where knowledge on liquidity issues and the nuances of individual issues can come in handy, potentially allowing an active manager the opportunity to add value.

25. Free ETF Tools Can Make Your Life Easier

The ETP universe now stands at more than 1,300 products–and is expanding rapidly. With a growing number of increasingly complex tools available to more and more investors, keeping track of all the choices and identifying the best product for your investment objectives is no easy task. But there are a number of free analytical resources out there designed specifically for financial advisors who use exchange-traded funds. Among the free tools available at ETFdb.com are:

- ETF Screener
- ETF Country Exposure Tool
- Stock Lookup Tool
- Mutual Fund-To-ETF Converter
- Head-To-Head ETF Comparison Tool

These tools help build a roadmap to successful investing strategies, allowing advisors to dissect the ETF universe in countless ways and easily compare products to finds the funds that are best for their clients.

Disclosure: No positions at time of writing.

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