9 Things You Should Know About ETFs

Exchange-traded funds are versatile, flexible and generally have low expenses; they offer several potential advantages over traditional mutual funds. But they're not for everyone.

1. ETFs tend to have low management expenses. While many actively managed stock mutual funds have expense ratios of more than 1%, ETFs tend to have the lowest costs, with some charging less than 0.1%.

2. ETFs’ trading costs may undercut their advantages. For investors who trade frequently or use dollar-cost averaging to make regular fund purchases, ETF trading costs add up and could make mutual funds a better option.

3. Are more tax-efficient than typical mutual funds. ETF investors incur tax liabilities through a tax on a gain from a sale of an ETF, which is similar to a gain on a mutual fund sale, or through a capital gain that the fund distributes. ETFs distribute capital gains less often than comparable mutual funds.

4. May not be the top performers but can provide competitive long-term results. Although the performance of an ETF can lag performance of a similar mutual fund in certain markets, because most ETFs are passively managed, they can provide long-term results at a low cost.

5. Can be bought or sold more frequently than mutual funds. Like stocks, ETFs trade throughout the day, so you can quickly sell or buy an ETF in a volatile market. Mutual funds are priced once daily and can be purchased only at the end of the trading day.

6. ETFs provide a clear, ongoing view of their holdings. These funds list their portfolios every day, so you can see exactly what your investment owns. Knowing the details of your investments can make you aware of possible risks and overexposure to particular sectors.

7. Provide convenient, immediate diversification. Holding a broad variety of investments can help diversify the risk of a portfolio and could increase returns. Buying just one ETF can give you a stake in hundreds of stocks or bonds.

8. Make it easier to gain access to very specialized investments. For example, ETFs have made it much more convenient to own precious metals such as gold because investors don’t have to take physical delivery of the commodity.

9. Can fill specialized niches in your stock portfolio. The proliferation of ETFs has brought with it specialized funds that reach all corners of the financial markets. You can find an ETF that specializes in energy, real estate, or other sectors.

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