Audio Script:

In this video we'll explain what an index is, and walk through some of the different types of indexes. Then we'll examine the case for index investing, in particular, through the use of ETFs, or Exchange Traded Funds. Lastly, we will examine some of our index ETFs and the different approaches they take to achieve specific exposures and outcomes.

What is an index?

So just what is an index?

An index is an indicator, or a measurement, that can be made for just about anything. In investing, an index tracks the performance of a group of securities such as stocks or bonds. Investors use indexes in many ways. Historically, they’ve been used to calculate the performance of a particular market or asset class. They are also often used to benchmark performance, whether of your own personal account, or the performance of a third-party or even of a mutual fund. Indexes are built in a standardized, and rules-based way, with the objective of replicating the performance of a specific slice of the market. An equity index, for example, groups together stocks with similar characteristics and determines how many shares of each are to be held. This will provide an idea of how that particular market or industry is performing. Indexes come in all shapes and sizes, and although some might have the same ingredients, the recipes could be different. Why? Well, just like people have different tastes, investors have different objectives. If you use the same ingredients, but hold them at different weights, you can adjust the outcome to better suit those objectives.

All indexes have some rules or criteria to determine their “recipe”. For example, an index that seeks to measure the performance of US large cap companies would only include those companies that are incorporated here in the US and are above a certain size. Companies that meet those requirements will be eligible for inclusion while those that do not, would be excluded. So looking at the grid on the right, Company A would be eligible for the index, but Company B would not, because it is a small, and not a large company. Company C would also be excluded. Although it is a large company, it’s based in Canada and not the US.

Indexing is not just an American thing. The MSCI EAFE index consists of large and mid-cap companies based in other developed regions like in Europe, Australasia, and Japan. It’s also not just used for stocks. The most well-known bond index, for example, is the Bloomberg US Aggregate Bond Index, commonly referred to as “the Agg”. It consists of US denominated investment grade bonds, made up primarily of bonds issued by the US government, as well as high quality corporate issuers.
But indexing has evolved now beyond these well-known, traditional approaches. Advancements in technology and the addition of big data, have allowed indexing to delve into more precise and more targeted exposures. One such index is the NYSE Global Autonomous Driving & Electric Vehicle Index, which is a bit harder to say than “the Agg”. That index goes beyond just holding companies that make cars. We’ll come back to that index a little later.

Index and ETF investing

Although some indexes have been calculated for 100 years, index investing is much newer, at just about 50 years old.

"Indexing" is a style of investing. Instead of picking which stocks to own and when to buy or sell them, an investor can build a portfolio by selecting an index to follow. By investing in all of the constituents of the index, the investor is looking to match the index performance.

But this can be challenging to do on your own. For example, let’s say you want to create a portfolio that includes all of the stocks in the S&P 500 at their respective weights. That would mean finding the list of stocks, and then buying all of them at the same proportions, which would mean making over 500 trades. And you’re not done there. Those constituents change on a preset schedule, which is called a rebalance. So rather than just buying all of the stocks once, you would need to regularly sell companies that are no longer in the index and purchase the ones that are added.

50 years ago, a predecessor firm of BlackRock overcame this challenge by creating the first investable index product. Through this invention, investors could capture the performance of an entire index with a single purchase. They’re most commonly available as mutual funds and exchange traded funds (or ETFs). Now you can buy an index ETF like our IVV, which follows the recipe for the S&P 500, owning all the sectors and stocks at the same weight as the index.

Index ETFs have revolutionized how people invest.

So let’s take a closer look at what an ETF is. ETF stands for exchange traded fund, and they offer many of the same benefits of mutual funds: they are portfolios managed by investment professionals who have resources at their disposal that most regular investors don’t. But unlike a mutual fund, ETFs can be bought or sold at any time during the trading day. And where most mutual funds are actively managed, most ETFs follow an index.

When we ask our customers what they like about iShares ETFs, we typically get one of three responses. First, ETFs provide diversification, providing access to potentially hundreds of securities, sometimes even thousands, in a single purchase. Second, ETFs are low-cost, which means that ETF investors are able to keep more of what they earn.

And lastly ETFs are typically more tax efficient, making them well suited for taxable brokerage accounts. ETFs are less likely to distribute capital gains, which means you are less likely to have to pay a capital gain tax while you still hold the fund. This is often an overlooked feature when determining which type of investment is best for you.

These are just some of the reasons why ETF adoption has been nothing short of exponential. The first stock ETF was launched in 1993 with the first bond ETF following in 2002. Although it took 16 years to reach 1 trillion dollars in ETF assets, it only took 4 more to reach the second trillion, and just 3 for the third. ETFs closed out 2021 with over 10 trillion dollars in global assets, with the bulk of that, about 5.4 trillion, in US ETFs. It’s no exaggeration to say that ETFs have revolutionized the way people invest, and democratized the investment industry in the process.
ETFs Today

So now that we've demystified indexes and explained how to access them through ETFs, let's take a closer look at the different approaches to index investing.

Early indexes and index ETFs were primarily focused on providing exposure to large groups of stocks. These products sliced up the stock market by the size of the company, large, mid, or small. Other ETFs might focus on providing exposure to specific asset classes, like bonds. But indexes are not one size fits all. Many investors have more specific objectives in mind, such as receiving regular income. There are a number of ETFs that will therefore look at specific attributes of a company, like whether or not it pays a dividend. But index ETFs have evolved to target not just specific asset classes, but attributes or themes as well, like clean energy, or driverless cars.

Let's start by taking a closer look at some broad-based index ETFs. IVV seeks to track the S&P 500, which is a market cap weighted index of 500 large cap US companies. Because it is market-cap weighted, the recipe calls for larger companies to make up a higher percentage than smaller companies. Many of the names held within IVV are familiar to most people, like Apple and Amazon.

IJR, on the other hand, seeks to track the S&P small cap 600. The recipe for that index calls for exposure to much smaller companies than you would find in IVV. Small cap stocks tend to be riskier than larger companies, but they could provide more growth potential. Because of the way S&P builds their indexes, a company would not be found in more than one size bucket or in more than one ETF that tracks each index.

As we mentioned earlier, indexing and ETFs are not specific to stocks. Bond ETFs are some of the fastest growing parts of the market. But the way bond indexes are built is a little bit different. Rather than by the size of the issuer, like with stocks, they tend to be broken down by credit risk. AGG, for example, seeks to track an index comprised of all investment grade bonds. These are bonds issued by companies that credit rating agencies view as having low chance of defaulting on their debt. It consists mostly of bonds issued by the US government, as well as corporations.

Another product, HYG, seeks to track an index that is comprised of riskier bonds that don’t meet the requirements for investment grade. This means the credit rating agencies view these issuers as having a higher risk of default than investment grade bonds. But because they are riskier, they also tend to provide higher yields.

The previous ETFs target broad exposures in differing ways, but some ETFs target a combination of exposures and securities with more specific attributes. Many investors have very specific objectives in mind. One example is generating income. One fund they often look to is DGRO or D. G. R. O, which is our iShares Core Dividend Growth ETF. The index methodology tries to narrow down the list of ingredients. Only those US stocks that have a 5-year track record of growing their dividends are eligible to be included, along with some additional criteria.

But maybe DGRO doesn’t generate enough income for you. Another fund, HDV, our High Dividend ETF may be an answer. The index HDV seeks to track examines a company's strengths to identify those that have a better chance of fending off their competitors, and therefore sustaining their dividends. One such company is Coca Cola, which has a strong brand name that competitors just can’t easily replicate. It’s that brand name that is why we so often pay more for Coca-Cola at the store, than the store brand that is right next to it on the shelf.

But stock attributes go beyond dividends and other fundamental characteristics. Some of our newest and most cutting edge ETFs seek to track indexes that are targeting specific innovations or trends. But identifying which company is going to be the chief beneficiary of a particular trend can be very difficult. Broad index ETFs are one solution, but they often offer more watered down exposure to any one specific theme. Our Megatrend index ETFs, though, are designed to let you invest in your most high-conviction ideas.
Sometimes companies that benefit from a trend are not associated at all with a particular idea or technology. Take self-driving and electric vehicles for example. We have an ETF, iDrive, IDRV, which seeks to track an Autonomous Driving and Electric Vehicle Index. Tesla is the first company most investors think of when they think about electric vehicles. But Tesla, and other EV manufacturers are reliant on other companies as well. For example, EVs need charging stations, which a company named ABB is involved in manufacturing. They also need batteries, which LG Chemical is involved in the manufacture of…. and those batteries, well they need lithium, which Albemarle produces. We employ a similar approach with our clean energy ETF, ICLN, which finds companies that build the equipment needed to generate clean energy, and not just clean energy providers.

So to recap what we talked about today, “indexing” is a style of investing. Instead of picking individual stocks to own and deciding when to buy or sell them, investors can invest directly in an index product like an ETF that does the work for them. ETFs provide competitive performance at a fraction of the cost of many other investment options, and are more tax efficient than traditional mutual funds.

An investor can get exposure to potentially hundreds of securities in an index with the purchase of just one index ETF. And indexing has evolved so that investors can find an ETF for not just a particular exposure, but also a more specific objective or trend. For these reasons, index ETFs have revolutionized how investors access markets build portfolios, and achieve their investment goals.

Thanks for watching.

**Spoken Disclosures:**

Visit www.ishares.com to view a prospectus, which includes investment objectives, risks, fees, expenses and other information that you should read and consider carefully before investing.

Investing involves risk, including possible loss of principal.

**On Screen Copy:**

Carefully consider the Funds’ investment objectives, risk factors, and charges and expenses before investing. This and other information can be found in the Funds’ prospectuses or, if available, the summary prospectuses which may be obtained by visiting www.ishares.com or www.blackrock.com. Read the prospectus carefully before investing.

Investing involves risk, including possible loss of principal.

Fixed income risks include interest-rate and credit risk. Typically, when interest rates rise, there is a corresponding decline in bond values. Credit risk refers to the possibility that the bond issuer will not be able to make principal and interest payments. Non-investment-grade debt securities (high-yield/junk bonds) may be subject to greater market fluctuations, risk of default or loss of income and principal than higher-rated securities. An investment in the Funds is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency and its return and yield will fluctuate with market conditions. There is no guarantee that dividends will be paid.

When comparing stocks or bonds and ETFs, it should be remembered that management fees associated with ETFs are not borne by investors in individual stocks or bonds. The annual management fees of ETFs may be substantially less than those of most mutual funds. Buying and selling shares of ETFs will result in brokerage commissions.

International investing involves risks, including risks related to foreign currency, limited liquidity, less government regulation and the possibility of substantial volatility due to adverse political, economic or other developments. These risks often are heightened for investments in emerging/developing markets, in concentrations of single countries or smaller capital markets. Funds that concentrate investments in specific...
industries, sectors, markets or asset classes may underperform or be more volatile than other industries, sectors, markets or asset classes and the general securities market.

The iShares Funds are not sponsored, endorsed, issued, sold or promoted by Bloomberg, BlackRock Index Services, LLC, Cohen & Steers, European Public Real Estate Association (“EPRA®”), FTSE International Limited (“FTSE”), ICE Data Indices, LLC, NSE Indices Ltd, JPMorgan, JPX Group, London Stock Exchange Group (“LSEG”), MSCI Inc., Markit Indices Limited, Morningstar, Inc., Nasdaq, Inc., National Association of Real Estate Investment Trusts (“NAREIT”), Nikkei, Inc., Russell or S&P Dow Jones Indices LLC. None of these companies make any representation regarding the advisability of investing in the Funds. With the exception of BlackRock Index Services, LLC, who is an affiliate, BlackRock Investments, LLC is not affiliated with the companies listed above.

Prepared by BlackRock Investments, LLC (“BRIL”), member FINRA and SIPC. BRIL is not affiliated with BofA Corp or any of its affiliates.

The strategies discussed are strictly for illustrative and educational purposes and are not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. There is no guarantee that any strategies discussed will be effective. There can be no assurance that an active trading market for shares of an ETF will develop or be maintained.

This material contains general information only and does not take into account an individual’s financial circumstances. This information should not be relied upon as a primary basis for an investment decision. Rather, an assessment should be made as to whether the information is appropriate in individual circumstances and consideration should be given to talking to a financial professional before making an investment decision.

©2022 BlackRock, Inc. All rights reserved. iSHARES and BLACKROCK are trademarks of BlackRock, Inc., or its subsidiaries in the United States and elsewhere. All other marks are the property of their respective owners.

Investing involves risk including possible loss of principal. Information is current as of the date of this material.

Any opinions expressed herein are from a third party and are given in good faith, are subject to change without notice, and are considered correct as of the stated date of their issue.

Merrill Lynch, Pierce, Fenner & Smith Incorporated is not a tax or legal advisor. Clients should consult a personal tax or legal advisor prior to making any tax or legal related investment decisions.

Bank of America Corporation (“Bank of America”) is a financial holding company that, through its subsidiaries and affiliated companies, provides banking and investment products and other financial services.

Merrill Lynch, Pierce, Fenner & Smith Incorporated (also referred to as “MLPF&S” or “Merrill”) makes available certain investment products sponsored, managed, distributed or provided by companies that are affiliates of Bank of America Corporation (“BofA Corp.”). MLPF&S is a registered broker-dealer, registered investment adviser, Member SIPC and a wholly owned subsidiary of BofA Corp. Merrill Lynch Life Agency Inc. (“MLLA”) is a licensed insurance agency and a wholly owned subsidiary of BofA Corp.

This material does not take into account a client’s particular investment objectives, financial situations, or needs and is not intended as a recommendation, offer or solicitation for the purchase or sale of any security or investment strategy. Merrill offers a broad range of brokerage, investment advisory (including financial planning) and other services. There are important differences between brokerage and investment advisory services, including the type of advice and assistance provided, the fees charged, and the rights and obligations of the parties. It is important to understand the differences, particularly when determining which
service or services to select. **For more information about these services and their differences, speak with your Merrill financial advisor.**

Nothing discussed or suggested in these materials should be construed as permission to supersede or circumvent any Bank of America, Merrill Lynch, Pierce, Fenner & Smith Incorporated policies, procedures, rules, and guidelines.

Investment products offered through MLPF&S and insurance and annuity products offered through Merrill Lynch Life Agency Inc.: Are Not FDIC Insured, May Lose Value, Are Not Bank Guaranteed, Are Not Insured by Any Federal Government Agency, Are Not Deposits, Are Not a Condition to Any Banking Service or Activity.