ETF

Diversify your investment portfolio.

An ETF offers you flexibility.

iA Securities

Exchange-traded funds, or ETFs, have become increasingly popular since they were introduced two decades ago. The easiest way to understand ETFs is to think of them as mutual funds that trade like stocks. Similar to mutual funds, ETFs minimize risk through diversification but they trade and pay out profits differently.

The basics

What you need to know about ETFs

What is an ETF?

An ETF is a hybrid investment that resembles an index mutual fund – a type of mutual fund with a portfolio that matches or tracks an underlying market index, like the S&P 500 or S&P/TSX Composite Index. An index fund, however, has its net asset value calculated at the end of the trading day, while an ETF, though it comprises equities like an index fund, trades in real-time like a stock with price fluctuations throughout the trading day. That means, with an ETF you have the diversification of an index fund as well as the freedom to buy and sell any time.

Diversification

A key benefit of an ETF is the opportunity it affords investors to diversify by tracking benchmark indices like the S&P 500. Because ETFs comprise many assets, they're not as potentially volatile as an investment in any one particular asset.

Professional management

An ETF doesn't have an active portfolio manager choosing component stocks to buy and sell, so it tends to have lower administration costs. That can mean more returns for you when it rises in value. However, because there's less active management, its value is more prone to fluctuation of the index it tracks. For example, if the S&P 500 drops, the ETF that follows it will drop by a similar percentage plus management fees.

FAQ5

Five questions and answers about ETFs

1 How do I buy an ETF?

You can buy or sell ETF shares through a fully licenced Investment Advisor any time the stock exchange is open. Similar to stock purchases, you'll usually pay a commission on each transaction.

2 Is an ETF risky?

A more diversified portfolio is usually considered less volatile than one that invests in individual stocks or bonds. ETFs do however come with a level of risk. For instance, if an ETF tracks a smaller index or a narrow or regional index, you can expect it to be more volatile. Also, just because an ETF is listed on an exchange doesn't guarantee there will be investors to buy shares from you when you're ready to sell.

3 How does an ETF make you money?

The amount of money you can earn from an ETF depends on the underlying investment(s) of the ETF. If, for example, you own an ETF that's focused on dividend stocks, you can make money from an increase in the price of the stock (capital gains) and the dividends those stocks pay out. On the other hand, if you own an ETF that's focused on bonds, you can make money from interest income and, potentially, capital gains. Income from your ETF investment in the form of interest, dividends or capital gains isn't usually reinvested as additional ETF shares. Instead it stays in your account as cash until you and your Investment Advisor decide what to do with it.

4 Why should I consider both ETFs and actively managed mutual funds?

An ETF is passively managed in that it tracks a market index while an actively managed mutual fund benefits from the knowledge and expertise of a portfolio manager. Owning both can help you achieve your asset allocation goals, diversify your portfolio by style as well as balance the overall costs of investing.

5 How is an ETF taxed?

You pay tax on any capital gains you make when you sell an ETF as well as any distributions, like dividends, that you receive. As with other investments, an ETF purchased in an RRSP isn't taxed until you take the money out of the account before or after retirement. And if you buy an ETF within a Tax-Free Savings Account (TFSA), you won't pay any tax on your capital gains or distributions at all.

Did you know?

$800,000
in extra savings

How much can you save from lower ETF expenses?

Consider this: for an 18 year old who saves $5,000 a year until retirement, the difference between a 7% and an 8% return, just 1% difference, could result in over $800,000 in additional savings.

900%

Canadian-listed ETF assets grew from $15 billion in 2006 to $135 billion in 2017 — that is an increase of 900%.

(Source: http://www.cetfa.ca/infocentre/stats.html)

Notes

It's important to have a solid investment strategy that addresses both short-term needs and long-term goals. Speak to an iA Securities Investment Advisor to learn more.

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