

ETFs Explained

WHAT IS AN ETF?

Exchange traded funds combine the benefits of stocks and mutual funds into one investment vehicle. Similar to owning individual stocks, ETFs can be traded throughout the day. And like mutual funds, ETFs provide the diversification of owning bundles of stocks, bonds, or other assets. This unique combination is why ETFs are called the “next generation mutual fund.”

ETFs VS. MUTUAL FUNDS

	AVERAGE FUND EXPENSE RATIOS	INDEXED (PASSIVELY MANAGED)	VISIBILITY INTO UNDERLYING HOLDINGS	CAPITAL GAINS TAXES	STYLE DRIFT (FUND MANAGERS STRAYING FROM INVESTMENT OBJECTIVES)	EASY DIVERSIFICATION ACROSS ASSET CLASSES?	CAN BE PURCHASED THROUGH ANY BROKERAGE ACCOUNT?	PRICED, BOUGHT AND SOLD THROUGHOUT THE DAY?
ETFs	Lower	Usually	Everyday	Lower	No	Yes	Yes	Yes
MUTUAL FUNDS	Higher	Usually Not	Quarterly	Higher	Yes	No	No	No

Lower Costs. Most ETFs have expense ratios substantially lower than most mutual funds. In fact, ETF expense ratios are typically 50-75% lower than mutual funds. Plus, unlike many mutual funds, ETFs never charge sales loads or 12b-1 fees.

Access to New Investment Opportunities. ETFs allow investors to access investment strategies and techniques that were previously only available to hedge funds and large sophisticated investors. With ETFs, you can precisely tailor your portfolio with exposure to equities, bonds, commodities, REITs, currencies, and even inverse and leveraged vehicles.

Greater Tax Efficiency. Unlike mutual funds (outside of retirement accounts), you do not pay taxes when other shareholders cash out of their positions. With ETFs, you pay taxes only when you decide to sell your shares. Because of the unique way they are structured, many ETFs have *never* paid a capital gain distribution.

Removal of Active Manager Risk. Most ETFs seek to track the performance of an index, such as the S&P 500 or Dow Jones Industrial Average, by investing in the underlying components of that index. ETFs, therefore, allow investors to remove the manager risk that comes with actively-managed mutual funds which research has shown, more often than not, underperform their index benchmarks over the long term.

Increased Transparency. ETFs are required to report holdings every day, so you always know what you hold in your portfolios. Mutual funds only disclose holdings quarterly, making it difficult to know what you own at any point in time. In addition, ETF management fees are clearly stated upfront, not hidden in the fine print or buried in obscure add-on fees.

Intraday Trading. ETFs can be bought and sold on the open market anytime during the trading day, allowing you to take advantage of investment opportunities whenever you want. With mutual funds, you can only buy or sell fund shares after the market closes. In addition, ETFs allow you to use stop loss orders, limit orders, and options. These are important risk management tools that mutual funds cannot provide.

Convenience. Mutual funds are typically sold by a mutual fund company or are purchased through a brokerage account, sometimes with a load or a fee attached. In addition, many mutual funds have minimum investment requirements. All ETFs can be purchased through any broker for whichever amount that you wish.

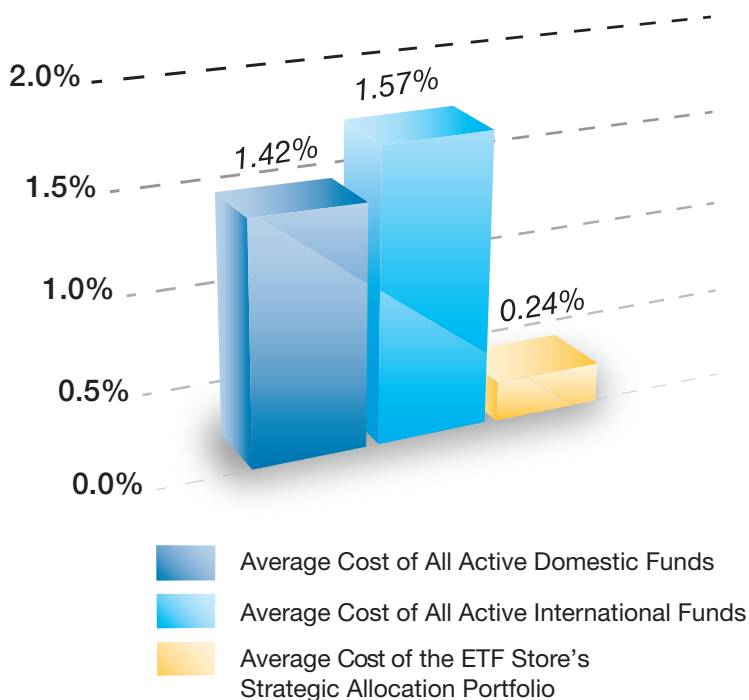
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THE IMPACT OF INVESTMENT EXPENSES AND TAXES ON YOUR MONEY

ETFs have been called **The Next Generation Mutual Fund**. Why? One of the biggest reasons is cost. On average, mutual funds have expenses that are much higher than ETFs. Also, ETFs can provide significant savings on your taxes.



source: Morningstar, Inc. February 2008

The Impact of Taxes, Fees and Expenses

on Your Investments. How much? The average expense ratio for actively managed US equity mutual funds is approximately 1.42%. The average ETF expense ratio for ETFs used in The ETF Store's Strategic Allocation Portfolio, for example, is approximately 0.24%. That's an annual savings of over 1% before you even get started.

In addition, mutual funds – and not ETFs – may charge sales loads and 12b-1 fees. Some of these sales loads can run upwards of 5% of your total investment!

Furthermore, annual capital gains distributions, which are taxable in non-qualified accounts, are typically much smaller with ETFs than

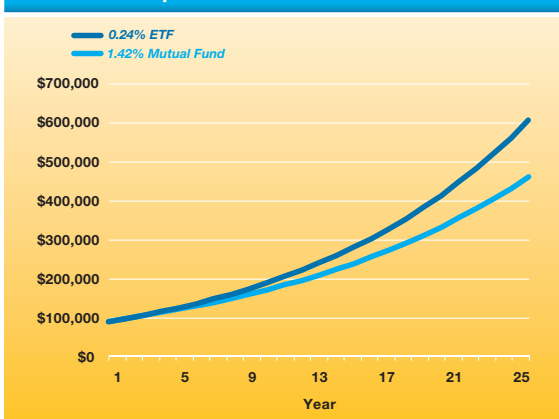
mutual funds. For example, iShares, the largest ETF issuer, distributed 0.02% of net asset value as capital gains in 2008 (a significant down market) while mutual funds, on average, distributed 3%.

Lower fees matter – a lot. Consider an investor starting with \$100,000 earning an 8% annual average return and paying 0.24% versus 1.42% in fees over a 25-year period. *The investor paying the lower fees ends up with nearly an additional \$150,000!*

Over time, the difference in fees charged by mutual funds versus ETFs can dramatically erode the value of your long-term assets.

Of course, lower fund fees and taxes are not the only reason to use ETFs. ETFs trade on the stock exchange so you can take advantage of investment opportunities whenever you want. They also enable you to invest in any sector, style, asset class, or market anywhere in the world, so you can easily get much broader asset allocation than what might be possible with mutual funds. Finally, ETFs publish what they own every day, so you do not have to worry about what your mutual fund manager is doing with your money.

Impact of Difference in Fees



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