WisdomTree®

What is an ETF and How Does it Differ from a Mutual Fund?

An exchange traded fund (ETF) is a type of security which can be purchased or sold on a stock exchange. It is an investment wrapper that represents a basket of securities and it typically tracks the performance of an index. The price of an ETF share will change throughout the trading day as the shares are bought and sold on the market.

SAME GOAL, NEW TECHNOLOGY

WHAT ARE THE KEY DIFFERENCES BETWEEN A MUTUAL FUND AND AN ETF?

	Mutual Funds	ETFs
How to buy/sell	Through the MF company or broker, end of day NAV	On-exchange, intraday
Transparency of holdings	Typically published quarterly, on at least a 30-day lag	Typically published daily
Minimum investment	May have high minimums	1 share
Trading costs	Costs of inflows/outflows shared by all holders; reduces NAV daily for all	ETF buyer/seller typically bears trading costs; all other investors typically not impacted
Tax efficiency	Portfolio manager must transact in the holdings which can generate capital gains	Generally considered more tax efficient due to secondary trading and in-kind create redeem process
Expense ratio	Generally higher	Generally lower
Transparency of extra fees	Sales Load, 12b-1 fees, trading fees of all in/outflows	Standard trade commissions plus the bid/ask spread
Liquidity	End of trading day	Available intraday

BENEFITS AND RISKS OF ETFs VS. MUTUAL FUNDS

BENEFITS OF ETFs:

+ A low cost & one share investment minimums[1]
+ One-click access to broad global markets and a wide array of investment strategies
+ Generally more tax efficient
  - ETF capital gains distributions are generally mitigated due to the in-kind creation redemption mechanism and the secondary market listing.
+ Intraday liquidity[2] and not just subject to end-of-day liquidity and pricing, as in a mutual fund
+ Typically full transparency
  - Daily Holdings
    – All holdings of the ETF are disclosed on issuer websites.
  - Fee Structure
    – ETFs have a published total expense ratio (TER).
  - Transaction Costs
    – These are explicit in the bid/ask spread.
+ Not typically affected by other investors' trading activity and transaction costs
+ No 12b-1 fees[3] or sales loads[4]

RISKS OF ETFs:

+ Execution risk
  - Choosing the wrong trade type or not understanding ETF best execution practices can cause an execution that is less desirable, which can affect returns.

SHARED RISKS:

+ Fund closure
  - Investors will not lose principal due to closure, as fund net asset value (NAV) at closure is returned. The risk is finding a similar investment vehicle and the tax consequence associated with liquidation.
+ Counterparty risk[5]
  - Only if an ETF or mutual fund uses over-the-counter (OTC) derivatives[6] within the fund does it have counterparty risk to the OTC derivative provider.
+ Performance risk of the underlying holdings
  - The return of the ETF or mutual fund is dictated by the returns of the underlying securities.

[1] Ordinary brokerage commissions apply.
[2] Liquidity: The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets.
[3] 12b-1 fee: An annual marketing or distribution fee in a mutual fund; this fee is considered an operational expense and is included in a fund's expense ratio.
[4] Sales Loads: Explicit commissions passed back to the broker
[5] Counterparty risk: the risk to each party of a contract that the counterparty will not live up to its contractual obligations.
[6] Over-the-counter (OTC) derivatives: Contracts that are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary.