Exchange Traded Funds (ETFs) Fact Sheet

Redmayne Bentley

Exchange Traded Funds (ETFs) are index-tracking funds which are listed and traded on a stock exchange like listed company shares. When buying a share in an ETF you are effectively buying a portion of the assets of a fund. These underlying assets are usually shares in the companies which make up the index or sector. ETFs allow UK investors to gain exposure to both domestic and overseas indices such as the FTSE 100, FTSE 250 and S&P 500 and allow exposure to these indices in one simple transaction. ETFs can offer a very low cost, straightforward method of stock market investment. Their aim is to track an index by holding the underlying shares or a derivative equivalent, allowing you to diversify a portfolio to reduce risk.

HOW ARE ETFs TRADED?

ETFs are quoted on the stock market. You can buy and sell ETFs in the same way as shares. Pricing and trading is in real time and you can call us at any time to obtain the latest price information.

iSHARES CORE FTSE 100 UCITS ETF

ETFs can be best illustrated by using an example, in this case the **iShares Core FTSE 100 UCITS ETF**. The aim of this fund is to provide a total return, including both capital and income factors, which reflects the return on the FTSE 100 index - a key benchmark of UK stock market performance. In order to track the performance of the FTSE 100 index the fund invests in securities that are constituents of the index itself.

The *i*Shares FTSE 100 trades at a fractional representation of the index headline figure. So, if the value of the FTSE 100 is 7250, you would expect the iShares FTSE 100 to be trading at around 725p per share. The iShares FTSE 100 ETF aims to pay a dividend quarterly to shareholders (this information relates to the distribution line).

iSHARES CORE S&P 500 ETF

The **iShares Core S&P 500 ETF** is an example of a UK-traded ETF that tracks a foreign index. The S&P 500 is one of the 'Big 3' US indices which provides benchmarking for the general US market. Much in the same way as the FTSE 100 is an indicator of the general strength of the UK stock market, the index itself contains household names such as **Apple**, **Amazon** and **Johnson & Johnson** and is keenly monitored by investors on both sides of the Atlantic. Investors can gain exposure to US and European indices plus Chinese and Japanese companies through ETFs. Please see the website detailed overleaf for access to a selection of ETFs currently available in the UK.

GETTING STARTED

Under the current regulations and the rules of the Financial Conduct Authority (FCA), we are required to satisfy ourselves that you have the experience and knowledge to enable you to understand the risk involved when dealing in 'complex instruments' such as some ETFs. Therefore, before you can trade in these you must undertake an assessment to demonstrate your knowledge and understanding of complex instruments, and this will involve completing our ***Complex Instruments: Appropriateness Assessment Form***.

THE BENEFITS OF ETFs

The annual management charges on ETFs can make them look attractive when compared to those of Unit Trusts. In addition, ETFs do not have any hidden charges such as initial or exit fees, only an annual management charge - you only pay the standard commission that your stockbroker charges to buy and sell. Currently, the structure of many ETFs means that they are classed as mutual funds, domiciled in the Republic of Ireland, for tax purposes, and therefore exempt from Stamp Duty. Coupled with the minimal management charges applied by the ETF Manager, this type of investment vehicle provides a very cost-effective method of gaining diversified exposure to the stock market.

Some ETFs hold the underlying shares, and so collect the dividends paid by the companies and distribute them to the holders of the ETF shares. The dividend policy varies from fund to fund, either quarterly, bi-annually, or annually. In short, you are not investing your cash in the abilities of one manager or group of directors or a single company's new product; you are spreading your risk over multiple companies and sectors in one easy transaction by diversifying your portfolio.

THE RISKS OF ETFs

As ETFs have grown in popularity, providers have begun to use different methods to gain exposure to the underlying investments, for instance 'swap-based' ETFs replicate the performance of an index through using index swap agreements. The complex nature of these agreements, involving 'swapping' assets between two or three different parties in order to generate a return equivalent to that of the index being tracked, means that there are additional risks involved that may not be apparent initially. In particular, although the return should still match the index in strong market conditions, the basket of assets may not replicate it and may potentially hold illiquid assets instead. Therefore, if market conditions worsen sharply, the provider may be forced to sell illiquid assets at a significant discount, which in turn will affect the price of the ETF and, in the worst case, may delay payment. Secondly, by introducing additional counterparties into the equation, the risk is heightened because the investment is only as safe as those parties the ETF provider is trading with. If they fail to honour the swap agreement or get into financial difficulties themselves, then the investment will also be impacted and might fail altogether.

COLLECTIVE INVESTMENTS AT A GLANCE – ETFs VS UNIT TRUSTS & INVESTMENT TRUSTS

FEATURES	ETFs	UNIT TRUSTS	INVESTMENT TRUSTS
Trading during market hours	Continuous	Once a day	Continuous
Real-time pricing	Yes	No	Yes
Transparent portfolio	Yes	Disclosed twice/year	Disclosed twice/year; top 10 holdings monthly
ISA Eligible	Yes	Yes	Yes

ETF PROVIDERS AND PRODUCTS

There are numerous providers of ETFs in the UK, offering multiple products. For the full list, please visit the London Stock Exchange website: **https://www.londonstockexchange.com/raise-finance/etps/etfs**

To find out more, contact your **usual Redmayne Bentley office** or call us on **0113 243 6941**.

The value of your investments and the income from them may go down as well as up, and you could get back less than you invested.

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