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WHY ETFs…WHY NOT?
Providing Multiple Benefits for Investors of All Shapes and Sizes

Diversification. Tax Efficiency. Ease of Trading. Liquidity. Low Costs.

For a variety of reasons, Exchange Traded Funds (ETFs) have become the "investment of choice" for many individuals and institutions. As of the end of 2004, over $225 billion in assets had found their way into ETFs representing various assets classes, sub-asset classes, investment styles, market-capitalizations, countries, and specific industry sectors. Structured to track the benchmark indexes, ETFs allow investors the opportunity to easily participate in virtually every market in an efficient, low cost manner and create very well-diversified, highly liquid portfolios.

However, in some circles ETFs have wrongly earned a reputation as a product for the "less experienced" or even the "do-it-yourself" investor. Occasionally advisors may hear the following comments (or something similar) and should be prepared to address them accordingly:

"I am far too experienced an investor to participate in ETFs. Surely I can generate 'Alpha' (excess return to the market) through more sophisticated products."

- Numerous studies show that asset allocation (more so than manager/fund selection, security selection, market timing, etc.) accounts for greater than 90% of the return of a given portfolio.
- A well-allocated portfolio of various ETFs can prove far more efficient and profitable than a less diversified portfolio of mutual funds or separate accounts.
- The more recent emergence of specialized industry sector and country (theme) ETFs allow knowledgeable investors the opportunity to include potentially "alpha" generating securities in a portfolio with all the related cost efficiencies and trading benefits.
- Sophisticated "Core-Satellite" strategies can be developed exclusively using ETFs by structuring a "Core" of more traditional equity and fixed income funds (Russell, Lehman Ag, EAFE, etc.) and adding "Satellites" that represent the specific "hot" (currently favorable) industry sectors and countries.
- Experienced investors who choose to maintain more "speculative" and potentially rewarding portfolios may also consider a more "conservative" ETF portfolio for a percentage of the overall assets.

*"**Since I invest primarily in market-driven ETFs, I can make my investment decisions on my own without the help of an advisor."***

- While ETFs maintain tremendous trading efficiencies, the key to an effective and profitable portfolio lies in the manner in which the dollars are properly allocated.
- Financial advisors can prove crucial in structuring well-allocated portfolios of ETFs by taking advantage of their knowledge of the markets in general, the global economy, and the effects of various industry sectors and country specific funds.
- Experienced advisors often possess far greater expertise in implementing successful "Core-Satellite" strategies using ETFs than do-it-yourself investors.
- As market and economic conditions change, advisors assist in recommending the necessary reallocations and rebalancing to help ensure that portfolios are structured in the most appropriate manner given the investors' expected returns and levels of risk tolerance.
- Regardless of the underlying securities, investors tend to become emotional with financially oriented decisions and can benefit from the advice and counsel of an independent and objective source.

"Since I own a market portfolio comprised of ETFs, I will not need to make many reallocation or rebalancing transactions."

- A well-allocated and diversified portfolio of ETFs will still fluctuate given changes in the underlying markets.
- The various asset classes, sub-classes, styles, sectors, and country funds will become over/underweight their original allocations as certain ETFs perform better than others.
- Similarly, as economic and market conditions change, different funds may fall into or out of favor which may require further adjustments to the portfolio.
- Regardless of the underlying securities, all portfolios should be reviewed for reallocations or rebalancing on a periodic (quarterly, annually) basis.

A portfolio consisting of multiple ETFs of various market indexes and specific themes (sectors and countries) can prove beneficial in allowing (all types of) investors to meet their return objectives given an acceptable level of associated risk. Such portfolios can provide tremendous advantages to the investor: diversification, tax efficiency, ease of trading, liquidity, low costs, etc. Bear in mind, while ETFs represent attractive options for some investors, many build portfolios using individual stocks and bonds, mutual funds, separate accounts, and/or other non-traditional investments and reap highly successful results. As always, the trusted financial advisor can serve a very productive role in identifying the most appropriate products for the individual investors and assist them in properly structuring their portfolios and implementing their unique strategies.