



You've Got the Whole World
in Your Hands:
A Lesson in Exchange Traded Funds



What is an Exchange Traded Fund?

What is an ETF?

- An Exchange-Traded Fund (or ETF) is an investment vehicle traded on stock exchanges, much like stocks
 - You can purchase an ETF, just like you would purchase shares of Exxon Mobil stock
- An ETF holds an underlying basket of assets, such as stocks or bonds, and trades at approximately the same price as this basket of securities
- Most ETFs track a market index, such as the S&P 500 or the Dow Jones Industrial Average

500 Stocks

MMM,
AAPL, XOM,
MSFT, PG...
...CAT, KO
MCD, CVX,
PFE, C

ETF Wrapper

S&P 500 ETF

SPY

ETF Fun Facts

- **When were ETFs created?**
 - ETFs have existed in the US since 1993, and in Europe since 1999
- **How big is the ETF Market?**
 - There are over 2000 ETFs in existence
 - ETFs hold over \$2 Trillion in assets
 - There are over 20 ETF Providers in the USA alone
- **Who are the largest ETF providers?**
 - State Street (SPDR)
 - Barclays (iShares)
 - Powershares
 - Vanguard

Why would You Buy an ETF?

What are the advantages?

- **Diversification**

- higher exposure to a broad array of asset classes
 - opportunity to gain access to assets with are not directly correlated
- immediate exposure to a basket of securities
 - Ex) one purchase gives significantly broader coverage to companies and sectors in the S&P 500

- **Accessibility**

- access to unique investments not available to individual investors due to size constraints and other regulatory issues
 - Currencies
 - Commodities
 - Emerging Markets
 - High Yield Debt

- **Take a View**

- allows investors to take a view on a specific sector or investment theme
 - Energy Equity
 - Japanese Yen
 - Medical Devices
 - Gold

How are ETFs Different from Mutual Funds?

- **Cost Effectiveness**

- average fee on US equity ETFs is 0.34% vs. 1.46% for the average equity mutual fund
- purchasing fewer securities lowers commission and transaction fees

- **Transparency**

- investors can view the holdings inside an ETF at any given time
- mutual funds are only required to submit quarterly holdings reports

- **Liquidity**

- ETFs trade anytime during the trading day therefore the investor can:
 - quickly respond to dynamic market and economic events
 - capture price swings during the days trading
- mutual funds only trade at the end of the day

- **Tax Efficiency**

- a mutual fund is a pooled investment creating difficulty to control tax impacts
 - You pay for other investors going in/out of the fund through distribution of capital gains/losses
- ETF investors own the underlying securities (no pool)
 - no tax surprises at the end of the year

ETF Pitfalls

What to consider when purchasing:

- **Index** – ETFs generally are created to track a specific index
 - determine how closely the ETF manager mimics the index’s performance
 - measured by their “Tracking Error” which can affect ETF performance
 - evaluate how strong the correlation is with the index it tracks

- **Size/Liquidity** – Bigger isn’t always better but size matters when...
 - it impacts liquidity which can make it hard to get in or out
 - the cost of trading increases because smaller ETFs generally have wider bid/ask spreads

- **Holdings** – How diversified am I?
 - consider if you are better off purchasing the ETF or the underlying securities
 - is your diversification as strong as it should be

- **Expense Ratio** – Always check the expense ratio (the built in fee of a fund)

Not all ETFs are Created Equal!

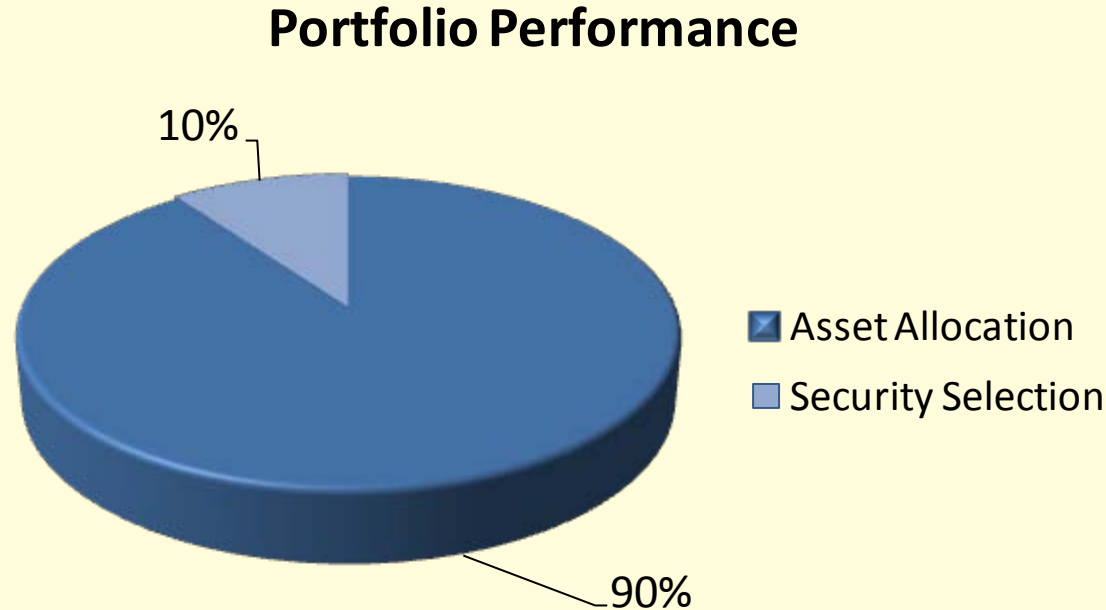
The ETF explosion:

- **Inverse ETFs** – allow investors to take a negative view on a market
 - Ex) Short Housing Sector
- **Leveraged ETFs** – investors can “double up” on a view
 - Ex) 2X the S&P 500
 - *Warning:* these should only be used for short term trades
- **Exchange Traded Notes (ETNs)** – ETNs are similar to ETFs with one big exception
 - ETNs are not backed by the securities, but by the credit of the issuing institution
 - Ex) JP Morgan MLP ETN
- **Commodity ETFs** – allows investors to invest in futures and forward commodity contracts
 - Ex) Oil
 - *Warning:* these ETFs do not track the market price of the actual commodity, and can cause adverse tax scenarios and can result in a K-1

How Do ETFs Fit into a Portfolio?

ETFs allow you to easily and efficiently diversify across asset classes.

It's all about what you own!



- Over time the main drivers of your portfolio's performance, are the asset classes you own (i.e. Cash, Fixed Income, or Equity) and when you owned them.
- Roughly **90%** of your portfolio performance is driven by the asset allocation, while only **10%** is attributed to security selection (i.e. Coke vs. Pepsi).¹

¹ Gary P. Brinson, L. Randolph Hood, and Gilbert L. Beebower, *Determinants of Portfolio Performance*, The Financial Analysts Journal, July/August 1986.

ETFs are a Passive Implementation Vehicle

Once your asset allocation has been determined, the next step is

Portfolio Implementation!

There are essentially 2 ways to implement a portfolio allocation:

- **Active Management** - is the process of picking individual securities, or hiring a money manager to pick securities with the goal of beating the benchmark (i.e. S&P 500) for each of your selected asset classes (Ex. Large Cap Growth, Emerging Markets, High Yield Bonds).
- **Passive Management** is the act of investing in the benchmark or market for each asset class selected, vs. taking specific individual stock views. This can be accomplished through ETFs.

Why Passive vs. Active?

- Over time, it has been proven that **active managers underperform** the benchmark roughly 60-70% of the time
 - “A semiannual study by Standard & Poor’s finds that over the five years ended June 30, only 37.1 percent of actively managed funds made up of large-capitalization stocks beat the category’s benchmark, the S.&P. 500.”¹
- Even when a manager does outperform, one can not be sure if the process is repeatable
 - “In picking any managed fund, you can never be certain that past success was a matter of skill, not luck.”²
- Active managers are also more **expensive** than passive strategies
 - This applies to Time Value and Dollar Value
- Active management can result in multiple accounts which increase accounting and reporting expenses.

^{1,2}The New York Times, 9/23/09, “Active vs. Passive: The Debate Keeps Going”



Speaker Biography

Whitney E. Solcher, CFA – Managing Director, San Antonio Capital Management, LLC, Partner, Board of Managers, Advisory Committee Member

Whitney Solcher is the Managing Director of San Antonio Capital Management, a Registered Investment Advisor. She is responsible for overseeing investment strategies, manager selection and capital allocation. Whitney is also the head wealth advisor and spends the majority of her time ensuring our client families receive appropriate investment advice, tailored to their individual needs.

Prior to her roll with San Antonio Capital Management, Whitney spent eight years with Goldman, Sachs & Co. in their Investment Management Division, where she held the title of Vice President after roles as a Financial Analyst and Associate with the firm. While at Goldman, Whitney advised some of the most successful entrepreneurs and businessmen in the state of Texas. Her responsibilities included risk analysis, asset allocation, manager selection, and estate and charitable planning.

Whitney is a graduate of The University of Texas Business Honors Program, with a second Major in Finance. She is a CFA Charterholder and member of the CFA Institute and the San Antonio CFA Chapter. A CFA Charterholder represents a tremendous reservoir of investment expertise, having demonstrated commitment to the highest standards of ethical and professional conduct, and comprehensive knowledge of investments and analytics. Whitney holds positions on the boards of Saint Mary's Hall, the Witte Museum, Founder's Council for The Southwest Foundation for Biomedical Research, and the UTSA Center for Innovation and Technology Entrepreneurship.

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