
THE LOW-DOWN ON ETFs

Exchange traded funds offer excellent exposure to underlying securities that you would otherwise have great difficulty investing in

WHAT IS AN EXCHANGE TRADED FUND?

An ETF is a listed instrument that tracks or mimics the performance of an index that consists of a basket of shares or bonds. In addition, the investor can also reap the return of the performance of a single commodity, such as gold bullion, through the gold ETF.

THE BENEFITS OF ETFs

Diversification

An ETF offers you exposure to a wide variety of underlying securities from various sectors, styles and countries that would have been quite inaccessible without the ETF.

The investor's money is now spread across the various securities in the fund, therefore reducing the amount of risk they would have faced had they only invested in a single company's shares.

Cost effectiveness

An ETF tracks the market's performance (passive management) and does not strive to outperform it (active management), meaning that there are reduced costs in the management of the ETF.

Cash flow distributions (dividends)

Should a company within the ETF pay out dividends, the dividends will be accumulated and distributed proportionally to the ETF unit holders either on a quarterly or semi-annual basis, depending on the structure of the ETF. Investors can also opt to have their cash flow distributions reinvested in the ETF.

Transparency

ETF prices are updated and made available throughout the day. In addition the underlying securities and their weightings within the ETF are also made available daily. The investor is therefore fully aware of what he or she is investing in.

Regulation

Most of the ETFs listed on the JSE are Collective Investment Schemes, meaning that they are regulated by the JSE and the Financial Services Board (FSB). Those ETFs that are not Collective Investment Schemes and are not regulated by the FSB are still regulated by the JSE.

Trading flexibility

ETFs are listed and traded like any ordinary share on the JSE and therefore can be bought or sold throughout trading hours. The price of the ETF is governed by the demand and supply of the actual ETF and the demand and supply of the ETF's underlying securities.

Liquidity

ETFs have dedicated market makers who are obliged to buy any ETFs that an investor wishes to sell and sell any ETFs the investor wishes to buy. ETFs therefore offer good liquidity.

Securities transfer tax exemption

Securities transfer tax would normally be levied on a purchase involving company shares. ETFs, however, are exempt from this.

Hassle free

The amount of research needed to investigate a particular ETF is a lot less than conducting research on more than 400 companies listed on the JSE.

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THINGS TO CONSIDER WHEN INVESTING IN ETFs Fees

Fees vary depending on the means by which you buy or sell ETFs. If you buy ETFs via a stockbroker you will pay brokerage fees, however the investor may then also invest in a variety of other listed products using his trading account. An annual administrative fee is charged by the ETF issuer through its investment plan offering.

Capital gains tax

Capital gains tax applies once the ETF is sold at a profit.

Tracking error

The ETF does not always track the index perfectly as certain costs are involved in the management of the ETF that affect its net asset value (NAV), therefore creating a discrepancy between the NAV price and the ETF price.

Market risk

ETF prices are affected by supply and demand, which means that these prices will fluctuate.

Share ownership rights

Owning an ETF does not give the investor the right to vote at AGMs of the underlying securities, as you own a portion (unit) in the fund and not the securities themselves.

HOW TO INVEST IN ETFs

- Through a stockbroker
- Through an ETF provider directly using a debit order (from a minimum amount of R300 per month) or making lump sum investments (from a minimum amount of R1 000).
- Through ETF platforms hosted by etfSA and itransact.

FULL PRODUCT RANGE

There are currently 30 ETFs listed by eight ETF issuers on the JSE. For a full list and a description of each, go to www.jse.co.za/etfs.

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