

# TIP BANK

Smart Ways to Save 'George'

## SAVING & SPENDING



**DIAMONDS—AND SPIDERS AND CUBES—ARE A BUSY GIRL'S BEST FRIEND: Consider Adding Exchange Traded Funds to Your Portfolio**

By Eve Kaplan

**Q**uestion: what investment product nearly doubled in value last year to reach \$210 billion? Answer: exchange traded funds, or ETF's, for short. As the name suggests, ETF's are "funds" (baskets of securities) "traded" on an "exchange." Just as with mutual funds, you can invest in stocks and bonds by means of ETF's.

Exchange traded funds are a form of index fund (a mutual fund that is comprised of securities weighted to mirror the results of a stock exchange index). They provide an inexpensive sampling of a broad or focused market or index. ETF's are a relatively new

financial product, and the number of offerings has exploded in the past few years. Perhaps you've heard of Spiders (SPDR), short for "Standard & Poor's Depository Receipts," which track the S&P 500 index.

***Doesn't every girl deserve Diamonds (DIA)—the ETF that tracks the Dow Jones Industrial Average?***

And doesn't every girl deserve Diamonds (DIA)—the ETF that tracks the Dow Jones Industrial Average? Then there are Cubes (QQQ), which track the (mostly) tech stocks in the NASDAQ 100, and iShares, which track other various broad and specialized indices. The cheapest ETF, the iShares S&P 500, only charges 0.09 percent annually.

Low fees are one of the major advantages of exchange traded funds. However, there are other advantages as well, that make them a more powerful investment choice than other forms of mutual funds.

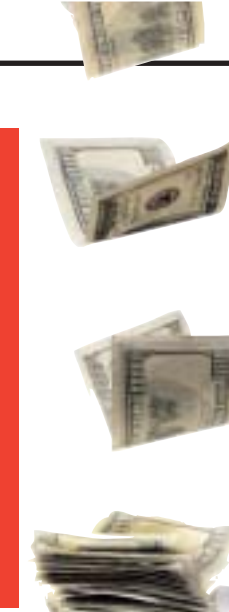
**\$** They can be bought and sold throughout the day, just as stocks can. (Mutual funds can only be bought and sold when their net asset value, or NAV, is set, at the end of every trading day.)

**\$** Like stocks, they can also be bought on margin or sold short (unless the ETF is held within an IRA account).

**\$** ETF's create less of a tax headache for shareholders than mutual funds do. Why? ETF managers often swap buy and

## ITEM OF INTEREST

**S**aving money the old-fashioned way—in a savings account, certificate of deposit or money-market account? Everyone has to keep a little bit of loose change—money they can get to quickly in an emergency—stashed somewhere, and short-term accounts like the above fit the bill perfectly. Problem is that while the amount of interest we pay creditors has been going up, up, up, the amount we earn on our savings has been dragging its heels. Online banks, such as ING Direct ([www.ingdirect.com](http://www.ingdirect.com)), E-Trade ([www.etrade.com](http://www.etrade.com)), and NetBank ([www.netbank.com](http://www.netbank.com)), among others, are leading the charge, however, offering yields substantially higher than the national average. At press time, for instance, ING's savings account was paying 2.60, NetBank's money market was offering 2.30, and E-Trade's paid out 2.25. The national average at press time—.56. You do the math.



sell orders for constituent shares (a like-kind exchange) to avoid a taxable event. Accordingly, ETF's are especially attractive to hold in taxable accounts.

### Are ETF's for You?

Basically, ETF's give you the benefits of a mutual fund with the flexibility of a stock. Before you place a buy order for an ETF, you need to decide if you want to be passive or active. This is not a reference to personality types! If you're an active investor, you think it's worth paying approximately 1 percent in expenses per year to own shares in an actively managed mutual fund that aims to outperform an index. But what if you happen to be invested in one of the majority of actively managed funds that, in fact, underperform (do less well than) a comparable index? (Historically, index funds have beaten the average active fund.) Unfortunately, you're out of luck—and you still have to pay the hefty management fee. With an index fund or ETF investment, you're a passive investor, wanting to get broad exposure to a market or index at little cost.

How much less do ETF's cost than index and actively managed mutual funds? The average domestic ETF has an expense ratio of 0.36 percent, according to Morningstar Inc. This easily beats the average no-load index fund's annual expense of 0.68 percent and the actively managed no-load fund's

average annual expense of more than 1 percent. OK, so they're cheap and convenient? What's the downside? Be aware of the following disadvantages:

**\$** ETF's, unlike open-ended mutual funds, cannot reinvest dividends. These are distributed and are taxable.

***ETF's represent an easy, inexpensive way to diversify your portfolio and invest for growth in the stock market. What busy woman wouldn't like that?***

**\$** You pay a brokerage commission to purchase ETF's. As a result, ETF's might be a more suitable investment if you intend to shift a large lump sum into an ETF and not add to it further. If you plan to augment your holding in an index fund on a regular basis, no-load, no-transaction-fee mutual funds are preferable to ETF's. That way you'll avoid the commission every time you buy.

### Some Tips

ETF's are a particularly efficient way to get exposure to more specialized markets—such as foreign markets—without paying the hefty expenses actively managed funds charge. If you want exposure to global large-cap stocks, for example, look at the

iShares S&P Global 100, which has an expense ratio of 0.4 percent per year and keeps approximately 90 percent of its money in global market leaders.

If you're investing in fixed income (bonds), ETF's are advantageous, because there is no "spread" (the amount between the buy and sell price when individual bonds are bought or sold through a broker). The average annual expense ratio of a bond ETF is approximately 0.15 percent versus 0.40 percent for an average index bond fund and 1 percent for a managed bond fund.

Bill Gross, the chief investment officer at Pimco and manager of the largest bond fund in the U.S., has suggested that investors look at Treasury Inflation Protected Securities (TIPS). These bonds, issued by the Federal government, are a hedge against rising interest rates. And, yes, there's an ETF that fits the bill: For exposure to this area, Bill Gross likes this ETF: iShares Lehman TIPS.

How do you buy ETF's? The easiest way is to go online to [www.etrade.com](http://www.etrade.com) or any of the other online trading sites ([www.schwab.com](http://www.schwab.com), [www.ameritrade.com](http://www.ameritrade.com),

etc.), where you can open an account with ease and trade ETF's for the same price as you would individual shares of stock.

ETF's will continue to generate more and more publicity as the market grows. They represent an easy, inexpensive way to diversify your portfolio and invest your money for growth in the stock market. What busy woman wouldn't like that? To do your own research on ETF's, check out the following Web sites:

The American Stock Exchange ([www.amex.com](http://www.amex.com)) is the primary exchange ETF's trade on; [www.ishares.com](http://www.ishares.com) lists both domestic and foreign ETF's; and [www.morningstar.com](http://www.morningstar.com), operated by the financial-services information provider Morningstar, offers comprehensive information on ETF's.

*Eve Kaplan is a fee-only Certified Financial Planner Practitioner, based in New Jersey, specializing in independent financial-planning advice with no asset and income minimums. Billing is hourly or by the project, with no products sold and no third-party considerations. She has 17 years of investment experience, having worked as an equities analyst and portfolio manager. For more information, visit [www.KaplanFinancialAdvisors.com](http://www.KaplanFinancialAdvisors.com).*

**Philly Women**

**Ladies...**  
finally a web resource just for you!

Visit Philly.com and click on "Philly Women" for the latest news and information on style, relationships, fitness and family!

- Helpful household tips from **FixIt**
- Relationship advice from America's #1 Flirtologist, Jill Spiegall
- Online shopping from local merchants you know and trust
- Join our Kitchen Table discussion group
- Family event planning and parenting advice from **Parents**

Visit Philly.com and click on Philly Women today!

**philly.com**  
THE REGION'S HOME PAGE

Advertisement



Click on CHANGE to Enter [www.makingbreadmagazine.com](http://www.makingbreadmagazine.com).