Investment in exchange-traded funds (ETFs) has boomed in recent years, with the growth rate for ETFs resembling the likes of a hockey stick curve. Today, there are over 503 different ETFs listed on Canadian stock exchanges to choose from—a huge variety of options for investors. Although mutual funds will continue to coexist with exchange-traded funds, the growth rate for ETFs has far surpassed the mutual fund industry since the global financial crisis of 2008/2009.

The growth in popularity of ETFs is indisputable, however, many investors are still in the dark when it comes to knowing and understanding what ETFs even are. This article contains a brief overview of the what, why and how of ETF investing: what is an ETF, why invest in ETFs and how you go about doing so.

So, what is an ETF?

ETF stands for Exchange-Traded Fund. An ETF is an investment vehicle that pools the money of many individual investors with similar investment goals and uses it to buy a variety of investments which are combined in a portfolio. If this seems like the definition of a mutual fund to you that would be correct because ETFs are a type of mutual fund.

The main difference between an ETF and a “conventional” mutual fund is the way investors buy or sell them. The “exchange-traded” part of the name means that ETFs are bought and sold through a broker on a stock exchange (like the Toronto Stock Exchange) the same way stocks are, while a traditional mutual fund is bought and sold, through a mutual fund dealer, directly with the mutual fund company.
The choice of investments within an ETF are primarily determined by the investment objectives and strategies of the ETF. Investments can be divided into types or asset classes. Common asset classes that ETFs may invest in, or gain exposure to, include equities (stocks) or fixed income investments (bonds). Some ETFs may also provide exposure to commodities (like oil, natural gas or gold) or use other specialized types of investments (like derivatives) to try to achieve a particular investment objective or strategy.

**Did you Know?**

Not all indices are created the same. In fact, the stock market can be sliced and diced in so many ways it has now been reported that in the U.S. there are more indexes than there are stocks.

**Why use ETFs?**

Like all investments, there are potential risks you and your advisor should discuss. You should also read the paperwork (called the offering documents) that is available for any particular ETF before making an investment. There are a few key benefits that stand out with respect to ETFs:

**Diversification** - Like most mutual funds, ETFs offer access to a diversified portfolio of securities that the average investor would have a difficult time acquiring by themselves due to the costs involved in doing so. ETFs that track broad market indices usually have hundreds or sometimes even thousands of securities. Diversification, however, does not protect you if the general market goes down but it does reduce the risk that any one individual security will have a material negative impact to your investment portfolio.

**Lower fees** - The ongoing management fee of an ETF is generally lower than the cost of a traditional mutual fund. Investors are usually charged a fee (commission) each time they buy or sell an ETF.

**Trading Flexibility** - Because ETFs trade on a stock exchange, they allow an investor to buy or sell throughout the day, whenever the stock market is open. ETFs also have the same flexibility in trading as stocks do - meaning you can put special stock trading stop, limit and short-selling orders on an ETF or even buy on margin (with borrowed money). Keep in mind that ETFs, like stocks or bonds that can fluctuate in value, will fluctuate along with the change in the value of the ETF’s underlying holdings.

**Transparency** - Many ETFs publish their portfolio of underlying securities daily. This means you can easily determine what underlying securities you own when you purchase a particular ETF investment.
How to buy and sell ETFs

To purchase and hold ETFs, investors need to have a brokerage account. Nearly all Canadian banks have related dealers (and some independents) that offer these types of accounts either through their full service brokerage or their discount brokerage.

Within a full service brokerage, investors work with an investment advisor. Alternatively, investors can purchase these investments through discount brokerage where they hold the responsibility to choose their investments and makes all the decisions on their own.

A tool for all

ETFs now give the average investor access and the tools needed to build a well-diversified investment portfolio at costs that approach what historically have been available only to large institutional investors. Their liquidity, accessibility and transparency all build on the benefits of mutual fund investing, and have made ETFs an increasingly popular investment option with both investment advisors and individual investors.