# 5 Reasons Why ETFs Make Sense

NIEMANN CAPITAL MANAGEMENT
Market Tested, Not Back Tested ™

Few money managers have more experience with mutual funds or exchange-trade funds than Niemann. In our firm's early days, we constructed our portfolios with mutual funds since ETF choices were relatively sparse during the 1990s and early 2000s. In those days mutual funds made the most sense to get the type of diversification and opportunity we wanted to offer our clients. But a lot of that has changed significantly in the past several years.

There are now more than 1,600 ETFs available that offer exposure to specific sectors, industries, indexes, countries, regions, asset classes and more. The choices are prolific, and their numbers are growing.

The assets invested in ETFs are surging. As of the end of 2013, there was more than $1.7 trillion invested in exchange-traded funds, (according to ETFdb.com), offering plenty of liquidity and opportunity. Moreover, ETF assets rose more than 2,000% in the past 13 years vs. 115% for mutual funds, as of the end of 2013, according to ETFdb.com.

## 5 reasons why ETFs make sense

1

**ETFs are less expensive than mutual funds.**
Hundreds of ETFs are available to trade commission free and most can be traded for less than $10. According to Morningstar, the average ETF expense ratio back in 2010 was 0.6%; Compare that to 0.73% for index mutual funds and 1.45% for actively managed mutual funds in the same year.

2

**ETFs are tax efficient.**
One of the biggest advantages ETFs have against mutual funds is they can be more tax-efficient. Mutual funds are required to pay distributions of all their income and realized gains each year. Distributions are taxable. ETFs do not distribute like mutual funds. Each investor has complete control of when they want to take their gains in an ETF (if they exist). However, some exchange-traded products do have tax complications. Exchange-traded notes (ETNs) that trade futures contracts generate a K-1 tax form. Niemann avoids ETNs altogether.

3

**ETFs are more transparent than mutual funds.**
An investment's transparency is crucial for many different reasons. One key difference between ETFs and mutual funds is investors can see the market price of an ETF change live during the trading day, like a stock. But most mutual funds don't provide market prices until the end of the trading day. This can be a big disadvantage if prices are moving aggressively up or down during the trading day. ETF investors can trade anytime during the day to take advantage of fluctuations while mutual fund investors have to settle for whatever the price is at the end of the day. Additionally, ETF holdings are updated daily. They can be viewed by visiting the ETF provider's website. Conversely, mutual fund holdings are much more difficult to obtain and updated less frequently.

4

**Everyone has trading access.**
Any broker/dealer or investor can freely trade ETFs. In the mutual fund world, funds are only available to trade at broker/dealers that sign distribution agreements, which can include a variety of hidden fees and subsidies. With exchange-traded funds, no companies control the creation of these products, the trading or access to them. This greatly reduces the ability of fund companies and broker/dealers to create unfair advantages in the marketplace.

5

**ETFs are not as risky as stocks.**
Many portfolio managers invest in individual stocks in an attempt to increase returns. This can result in over exposure to an individual stock and too much portfolio volatility. In contrast, ETFs offer exposure to more diversified opportunities in specific sectors, industries, countries and so forth. There could potentially be hundreds of individual stocks in one sector ETF and thousands in an index ETF. Of course, there are exceptions. Some ETFs can be very risky. Investors should always read a fund's prospectus before investing any money.

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