Introduction to ETF investing

What is an ETF?

Like their name suggests, Exchange Traded Funds or ETFs, are managed funds that are traded on ASX, just like shares. When you buy units in an ETF you don't just get shares in one company, you get a diversified portfolio of securities in a single trade saving you time and money.

Since being launched in 1989, the global ETF industry recently surpassed US$3.5 trillion in assets under management[1]. Although relatively new to Australia the ETF industry has experienced rapid growth exceeding A$26 billion[2].

ETFs combine the benefits of managed funds and listed shares

ETFs combine characteristics of traditional unlisted managed funds with the benefits of listed shares. Like managed funds ETFs pool money from investors into a 'fund' which is professionally managed. Like listed shares, ETFs trade on the ASX so investors benefit from simple trading and pricing throughout the trading day. This is different from unlisted managed funds where investors can only invest and withdraw directly with the fund manager based on a single daily price which investors do not know until the next day.

Features of ETFs compared with other common financial products

Investment vehicle	Listed on ASX?	100% holding transparency	Live pricing	Live trading	Diversified exposure via one trade
ETFs	Yes	Daily	Yes	Yes	Yes
Direct shares	Yes	-	Yes	Yes	No
Unlisted managed funds	No	No	No	No	Yes
Listed Investment Company (LIC)	Yes	Monthly	Yes	Yes	Yes

Why ETFs are so popular

Diversification with a single trade

With an ETF, investors can diversify their porfolio across asset classes and sectors both locally and internationally.

Liquidity

With an ETF you can buy and sell your investment simply and quickly on the ASX. Liquidity in an ETF is facilitated by a 'Market Maker'. The Market Maker's role is to match buy and sell orders for ETF units on ASX which means you can buy when you want and sell when you need.

[1] According to ETFGI's February 2017 gloal ETF and ETP industry insights report

[2] According to ASX Monthly Funds data, February 2016

Transparency

ETFs provide investors with transparency of portfolio holdings and market prices. The portfolios of securities held in VanEck's ETFs are published on our website on a daily basis. Market prices are continuously quoted during each ASX trading day.

Flexibility

As they are quoted on the ASX, ETFs give you the flexibility to trade throughout the day, just like trading shares. Like a share, 'bid' and 'ask' prices (aka 'market prices') for ETFs are published on the ASX and online broker websites. ETFs that hold ASX listed companies are also required to publish an indicative unit price called an 'iNAV'. The iNAV allows investors to track the fair value of the ETF unit prices against market prices throughout the day to help decide when to buy and sell. iNAVs are available from brokers or financial advisers.

For more information on trading ETFs go to 'How to trade an ETF' on our website.

Passive management

ETFs are index funds. This means they track the performance of a benchmark index by buying the shares or bonds that are in the index. This is called 'passive management' as the ETF manager is not actively making investment decisions, but simply following the index.

The benefit of this approach is that it reduces transaction costs and capital gains tax liability for investors. Passive management has been shown to outperform actively managed funds over the long term.

Fees

Since ETFs track an index, they are typically able to achieve lower operating costs. As a result they charge management costs which are generally lower compared to actively managed funds.

Tax treatment

The two main features of ETFs to consider from a tax perspective are franking credits and capital gains tax.

1. Franking Credits

Franking credits flow through ETFs, from the underlying shares to investors.

2. Capital Gains

As passive funds, ETFs typically have low turnover and therefore generate low levels of capital gains tax liability.

Additionally, ETFs generally shield investors from higher capital gains tax liability resulting from withdrawal by other investors.

In unlisted managed funds, when an investor withdraws from the fund they leave behind the capital gains created through selling shares to pay their withdrawal. If there are a lot of investors withdrawing this can be a significant tax burden for the remaining investors. This does not happen in an ETF when investors sell their ETF units on the ASX to other investors or financial institutions appointed by VanEck to assist with the operation of the ETF. Only these institutions may make withdrawals that results in selling shares. If they do withdraw their capital gains and the associated tax liability go with them.

For more information on tax go to 'The tax advantages of ETFs' on our website.

In summary

ETFs have the benefits of both managed funds and listed shares.
The key points to remember are:

- ETFs are priced and traded throughout the day on ASX like shares;
- ETFs are diversified like managed funds;
- ETFs give you full transparency as to the underlying holdings on a daily basis unlike managed funds;
- ETFs are cost effective relative to actively managed funds; and
- ETFs have tax advantages compared to unlisted managed funds.

Contact us

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Important notice: