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Thread: [What is an ETF?](#)

TrueKings - January 24, 2021, 11:29 am

An ETF, or exchange traded fund, is a simplistic investment vehicle. For the definition of the century, it is a fund that is traded on an exchange. Now, for a little more detail on what an ETF is, rather than a definition you would give back in grade school. Essentially, an ETF is a group of stocks, mutual funds, or other ETF's that is typically built to track the performance of an index.

Since ETF's are built to track an index they can be automated to some degree by the company. Since there is less work involved in the day-to-day of the ETF, the costs tend to be lower. This is specifically evident in the cost of Vanguard ETF's when compared to comparable mutual funds. Speaking of the automation, a great upside to an ETF is that they are rebalanced for you. Every quarter, the S&P 500 changes in the way that some companies are held in a higher percentage than they were previously. To keep the general risk in the same ballpark the percentage each of these companies hold within the S&P must change. If you purchase an ETF that follows the S&P, \$SPY, that ETF will automatically change the percentage of each company automatically to track the S&P. If, however, you purchased each of the stocks in the S&P yourself, you will need to manually change these percentages to accurately track the underlying index.

Say you have \$1000, and want to invest in the market, but do not want to take on more risk than investing in the S&P 500, or what is called "market risk". To do this, you could find certain stocks with a beta averaging out to 1, and balance accordingly. Alternatively, you could purchase all the stocks in the S&P. However, at \$1,000 you do not have enough funds to purchase each of the companies in the proper weight. So, what do you do? You could purchase an ETF designed to track the SPY. This will give you exactly the risk profile that you are looking for at an affordable price.

The largest downside for index funds is their passive nature – especially if you are early in the accumulation stages of your life. The reason the funds are cheap is the same reason they may not be the best option for someone who can take on more risk. By simply tracking an index you are only taking market risk. Now, there is still profit potential in purchasing the index, but at the early accumulation stages it may be more beneficial to take the risk on individual companies. Scary, I know. But if you were just entering the work force 5 years ago you can take risks. Here is a pretty good example. People, five years ago, and still today, are very into GOOGL, FB, AAPL, and TSLA. These companies weren't new, and many people in their 20's love these companies. What would have happened if we had invested in any of these companies 5 years ago vs. putting our money into an ETF tracking the S&P 500.

You would have made money by using any of these investment methods. However, if you had purchased any one of the companies mentioned above vs. the S&P, you would have made far more. This is an important distinction for those early in their accumulation phase. It is also important to remember, that if you are late in this stage, it might be better to take less risks to preserve your capital. Later we will get into how you can structure your portfolio to slide along with your age – taking less risk as you age, protecting your nestegg along the way.

SecureOp - January 24, 2021, 11:45 am

Really well done explanation on ETFs, and differentiating the risk vs opportunity.

I personally take a liking to them for the huge benefits that you can construct to pay near zero to minimal tax, legally.

Edit: needed to clarify that the above sentence is more directed to crypto ETFs as the regulations are still in motion.

Ivex - January 24, 2021, 12:03 pm

All seriousness, nice to see a genuinely helpful thread here.

My ETF basket is:

- Vanguard S&P 500 (40%)
- iShares FTSE 100 (32%)
- iShares Global Clean Energy (14%)
- Fidelity China (8%)
- Lyxor MSCI India (4%)
- iShares MSCI Brazil (2%)

Falicty - January 24, 2021, 7:17 pm

An ETF is what you use when you wanna use a countries dosh in another country

LSD - January 26, 2021, 3:12 am

I came here expecting to explain what it was lol.

All on on \$BB tho