

# ETF Total Cost of Ownership (TCO)

For Professional Clients only

## TCO at a glance

- ◆ ETFs are mutual funds with a secondary market, and as such, have different cost structures to a standard mutual fund
- ◆ ETF costs can be thought of in two broad categories: costs of holding the fund and costs of trading the fund
- ◆ Just like mutual funds, ETF holders are still be required to pay annual management fees
- ◆ Given the secondary market of an ETF, investors will often have to pay brokerage commissions on dealing and bid/ask spreads

## Costs of trading the fund



**Brokerage fees:** most investors when transacting ETFs will have to pay a brokerage fee for the buying/selling of the ETF



**Bid/ask spread:** ETFs have a bid/ask spread which reflects the costs the APs (Authorised Participants) pay in the primary market to create and redeem the ETF. This spread usually widens in illiquid underlying markets and times of market stress

## Cost of holding the fund (tracking difference)



**TER:** annual all-in fee (usually percentage of assets) which includes the management fee and all administrative costs



**Trading costs:** additional costs of trading within the underlying portfolio. Higher turnover in the underlying portfolio often leads to higher trading costs in the ETF

## Other considerations for tracking difference



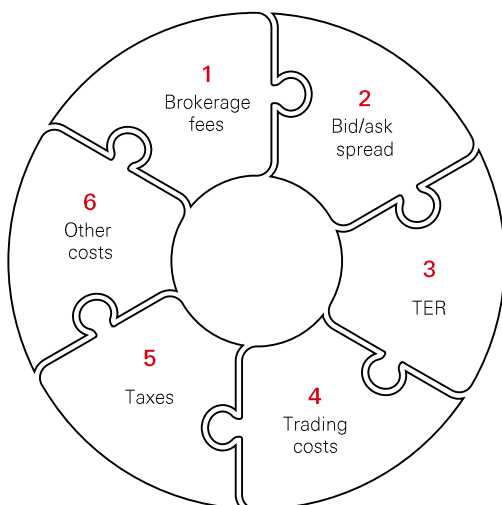
**Cash drag:** holding cash in the ETF portfolio has an effect on performance. Often this is most noticeable following the ETF receiving a dividend and either distributing or reinvesting the proceeds



**Taxes:** withholding tax (WHT) on dividends can reduce returns, but some ETFs have beneficial tax arrangements due to their structure and domicile (where the fund is registered) which can lessen the impact of WHT vs the benchmark



**Securities lending:** some ETFs engage in 'securities lending', which is when stocks within the portfolio are 'lent' out to short sellers for a fee. Part of this fee is normally added back to fund performance



## Key risks

The value of an investment in the portfolios and any income from them can go down as well as up and as with any investment you may not receive back the amount originally invested.

- ◆ **Concentration Risk:** The Fund may be concentrated in a limited number of securities, economic sectors and/or countries. As a result, it may be more volatile and have a greater risk of loss than more broadly diversified funds
- ◆ **Counterparty Risk:** The possibility that the counterparty to a transaction may be unwilling or unable to meet its obligations
- ◆ **Derivatives Risk:** Derivatives can behave unexpectedly. The pricing and volatility of many derivatives may diverge from strictly reflecting the pricing or volatility of their underlying reference(s), instrument or asset
- ◆ **Emerging Markets Risk:** Emerging markets are less established, and often more volatile, than developed markets and involve higher risks, particularly market, liquidity and currency risks
- ◆ **Exchange Rate Risk:** Changes in currency exchange rates could reduce or increase investment gains or investment losses, in some cases significantly
- ◆ **Index Tracking Risk:** To the extent that the Fund seeks to replicate index performance by holding individual securities, there is no guarantee that its composition or performance will exactly match that of the target index at any given time ("tracking error")
- ◆ **Investment Fund Risk:** Investing in other funds involves certain risks an investor would not face if investing in markets directly. Governance of underlying assets can be the responsibility of third-party managers
- ◆ **Investment Leverage Risk:** Investment Leverage occurs when the economic exposure is greater than the amount invested, such as when derivatives are used. A Fund that employs leverage may experience greater gains and/or losses due to the amplification effect from a movement in the price of the reference source
- ◆ **Liquidity Risk:** Liquidity Risk is the risk that a Fund may encounter difficulties meeting its obligations in respect of financial liabilities that are settled by delivering cash or other financial assets, thereby compromising existing or remaining investors
- ◆ **Operational Risk:** Operational risks may subject the Fund to errors affecting transactions, valuation, accounting, and financial reporting, among other things
- ◆ **Real Estate Investments Risk:** Real estate and related investments can be negatively impacted by any factor that makes an area or individual property less valuable

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