Table of Contents

The Ultimate Guide to ETFs ................................................................. 3
What are Exchange-Traded Funds? .................................................... 4
What do ETFs track? .......................................................................... 4
How do ETFs Work? ........................................................................ 5
Benefits of ETFs .............................................................................. 6
Cons of ETFs .................................................................................... 7
Guide to Important ETFs ................................................................... 8
Stock Index ETFs .............................................................................. 9
Industry and Sector ETFs ................................................................. 12
Commodity ETFs .............................................................................. 16
Country and Currency ETFs ............................................................. 18
Bond ETFs ....................................................................................... 20
Volatility ETFs ................................................................................ 22
The Ultimate Guide to ETFs

Exchange-traded funds, or ETFs, are a fast-growing segment of the stock market. Investors have embraced their versatility, diversification, and ease of use. This guide will cover the basics of ETFs, followed by more detailed explanations of their benefits and uses.
What are Exchange-Traded Funds?

ETFs group multiple assets under a single umbrella. Investors buying shares in a mutual fund or ETF receive proportional ownership across the underlying assets. These are usually stocks; however, ETFs can also hold commodities, bonds, and currencies. Unlike traditional mutual funds, ETFs are traded like stocks, and the price changes as shares are bought and sold on exchanges.

Like many mutual funds, ETFs can follow an index. Indexes are a statistical construct tracking the value of assets over time.

What do ETFs track?

While many popular ETFs are based on major stock indexes like the S&P 500, they can track a wide range of assets. Here’s a quick rundown of the major ETF types:

- **Stock-based ETFs** are pegged to major indexes like the S&P 500 or Nasdaq-100. Others track specific sectors like technology or industry groups like semiconductors.

- **Commodity-based ETFs** are designed to reflect the price of products like gold, silver, or oil. Others follow agricultural commodities. However, these ETFs seldom hold the physical commodity. Instead, they typically own derivatives like futures.

- **Foreign-exchange ETFs** follow currencies like the Euro, Yen, or Swiss Franc.

- **Country-based ETFs** are designed to track the national stock markets of other countries like Germany, the U.K., and China.

- **Bond-based ETFs** hold various types of bonds. Some focus on Treasuries (viewed as having no default risk), investment-grade bonds (low default risk), or high-yield bonds (higher default risk).

- **Volatility-based ETFs** are linked to volatility indexes like the VIX. These are complex derivative instruments, often designed to gain value when the broader market declines.
How do ETFs Work?

ETFs are issued by sponsors like fund managers or financial companies that create and administer the ETF. Examples include State Street, Vanguard, and Blackrock.

They rely on “authorized participants” to track their underlying index. Authorized participants are usually big Wall Street banks with a special right to create and remove shares in the market.

For example, say an ETF tracks an index like the S&P 500 or Nasdaq-100. If a surge of buying pushes the fund above its correct price relative to the index, authorized participants create new shares. They sell these into the market, lowering its price to the correct level. In return for the money they get from selling, authorized participants give the underlying assets (shares in the S&P 500 or Nasdaq-100 companies) to the sponsor.

This mechanism works in reverse when an ETF falls below its correct price. The authorized participants buy shares cheaply, which they eliminate from circulation. The sponsor then gives them shares of the underlying companies in return. In both cases, authorized participants make money keeping prices in-sync across the market.

Some people will recognize this as a form of financial “arbitrage” to ensure that ETFs track their intended indexes smoothly.
Benefits of ETFs

ETFs trade like stocks
The most important benefit of ETFs is the fact that they trade in normal brokerage accounts. They’re quoted throughout the day like stocks, even though they’re technically mutual funds. This is a major advantage over traditional mutual funds, which can only be bought or sold at each day’s closing price. **Intraday pricing is a major benefit of ETFs.**

ETFs have lower costs than traditional mutual funds
Networks of financial advisors normally distribute traditional mutual funds. That creates the need for higher fees to pay their sales commissions.

ETFs don’t have this cost because they’re accessible via most brokerage accounts. As a result, they may have less than half the expense ratio of a traditional mutual fund with the same underlying index.

ETFs trade options
Options are derivatives that let traders leverage moves in the market. “Calls” can appreciate more quickly when prices rise, while “puts” can appreciate more quickly to the downside.

This creates opportunities for both traders and investors. Traders can position for quick rallies or declines in the broader market or a specific sector. Investors can also use calls and puts to manage risk (hedge) core holdings.

Sector ETFs reduce single-stock risk
One of the main uses of ETFs is for tracking sectors and industry groups. These include information technology, homebuilders, banks, or energy.

Each of these groups includes several individual companies, which may lag their broader group at any point in time. Investors can avoid this single-stock risk with ETFs because they own wider baskets of firms.

ETFs give exposure to commodities and bonds in traditional brokerage accounts
Previously, traders needed dedicated futures accounts to buy and sell commodities like oil and gold. But now they are accessible in traditional brokerage accounts thanks to ETFs.
Cons of ETFs

1. **Some have poor liquidity**
   Aside from the normal risk of market prices falling, a drawback of some ETFs can be poor liquidity. Liquidity is related to the amount of trading activity an asset has. Greater liquidity typically means a stock or ETF is more actively traded and easier to transact, resulting in lower transaction risk.

   Many ETFs have lower liquidity because they trade only a few thousand shares per session. This is a potential factor that can result in higher costs. Investors should always check a fund's average daily volume and bid/ask spread for a sense of its liquidity. They may want to consider avoiding thinly traded ETFs.

2. **Understanding leveraged funds**
   Some ETFs are designed to move two or three times more than the underlying index. Others, known as inverse or bearish funds, move in the opposite direction.

   Leveraged and inverse ETFs are complex instruments because they use derivatives to generate returns. Investors should thoroughly understand their risks before trading them. A sample is included below. Each ETF is unique, verify the details before you trade.
Guide to Important ETFs

ETFs may trade like stocks, but they are more like mutual funds and index funds, which can vary greatly in terms of their underlying assets and investment goals. Below are a few common types of ETFs. These ETFs are categorized by the types of investments held within the ETF. This listing for information purposes was created in Spring 2020.
Stock Index ETFs

These ETFs track major stock indexes. They’re some of the most active products for both individual and institutional investors.
Stock index ETFs

SPDR S&P 500 ETF (SPY) is based on the S&P 500, the most widely followed index. It's also the most heavily traded symbol in both the stock and options market. Each dollar of SPY represents 10 points on the S&P 500 index.

- SPY has several competing funds that trade similarly:
  - Vanguard S&P 500 ETF (VOO)
  - iShares Core S&P 500 (IVV)

- Some leveraged funds also follow the S&P 500:
  - ProShares Ultra S&P 500 (SSO): Designed to deliver twice the move of the S&P 500
  - Direxion Daily S&P 500 Bull 3x (SPXL): Designed to deliver triple the move of the S&P 500

- Some inverse funds are based on the S&P 500 (moving in the opposite direction):
  - ProShares Trust Short S&P 500 (SH): Moves in the opposite direction as the S&P 500, on a 1-for-1 basis
  - ProShares UltraShort S&P 500 (SDS): Designed to deliver twice the move of the S&P 500, in the opposite direction
  - Direxion Daily S&P 500 Bear 3x (SPXS): Designed to deliver triple the move of the S&P 500, in the opposite direction
Stock index ETFs

**Invesco QQQ Trust (QQQ)** is based on the Nasdaq-100. This index is restricted to companies trading on the Nasdaq Stock Exchange. It’s heavily focused on technology companies.

- This leveraged fund follows the Nasdaq-100: ↑
  - ProShares UltraPro QQQ (TQQQ): Designed to deliver triple the move of the Nasdaq-100

- This inverse fund leveraged fund is based on the Nasdaq-100: ↓
  - ProShares UltraPro Short QQQ (SQQQ): Designed to deliver triple the move of the Nasdaq-100, in the opposite direction

**iShares Russell 2000 ETF (IWM)** is based on the Russell 2000 small-cap index. Its members are smaller companies with a greater focus on traditional industries and the domestic economy. IWM tends to be the most economically cyclical of the major stock funds. Each dollar of IWM represents 10 points in the Russell 2000 index.

- This leveraged fund follows small caps: ↑
  - Direxion Small Cap Bull 3x (TNA): Designed to deliver triple the move of the Russell-2000

- This inverse fund leveraged fund is based on the Nasdaq-100: ↓
  - Direxion Small Cap Bear 3x (TZA): Designed to deliver triple the move of the Russell-2000, in the opposite direction

**SPDR Dow Jones Industrial Average ETF (DIA)** is based on the Dow Jones Industrial Average. Its members are among the largest and most established companies in the market. Each dollar of DIA represents 100 points in the Dow Jones Industrial Average.
Industry and Sector ETFs

These ETFs track stocks in specific sectors and industry groups. Some sectors have lower-level industries beneath them. Most sectors are either cyclical (economically sensitive) or non-cyclical (not sensitive to the economy).
**Industry and Sector ETFs**

**S&P Technology Select Sector ETF (XLK)** tracks the market’s largest sector. It’s mostly driven by business investment, but individual product cycles are also important. XLK’s members are mostly cyclical. Its biggest holding is Microsoft.

XLK’s industry groups include software, semiconductors, I.T. services, and I.T. hardware.

- These actively traded funds represent smaller niches within the Technology Sector:
  - Market Vectors Semiconductor ETF (SMH)
  - iShares N America Software (IGV)

**S&P Technology Health Care ETF (XLV)** tracks the No. 2 sector by size. It’s mostly driven by demographic trends and innovation. There can also be a political risk and significant variation between companies. XLV’s members are non-cyclical. Its biggest holding is Johnson & Johnson.

XLV’s industry groups include pharmaceuticals, health-care equipment & supplies, health-care providers, and biotechnology.

- This actively traded fund represents a smaller niche within the Health Care Sector:
  - SPDR S&P Biotechnology (XBI)

**S&P Financial ETF (XLF)** tracks the market’s third-largest sector. Its members are cyclical, benefiting from strong economic growth, and performing worse during recessions. Its biggest holding is JPMorgan Chase.

XLF’s industry groups include banks, capital markets, and insurance companies.

- This actively traded fund represents a smaller niche within the Financial Sector:
  - SPDR S&P Regional Banks (KRE)
Industry and Sector ETFs

**SPDR Consumer Discretionary (XLY)** tracks the market’s No. 4 sector by size. Its members are cyclical because they mostly sell non-essential goods and services. Its biggest holding is Amazon.com.

XLY's industry groups include Internet and direct marketing, specialty retail, and hotels & restaurants.

- **These actively traded funds represent smaller niches within the Consumer-Discretionary Sector:**
  - SPDR S&P Retail ETF (XRT)
  - iShares U.S. Home Construction (ITB)

**SPDR Communications (XLC)** tracks Communications, which was established as a sector in 2018. Its members are mostly cyclical because many rely on advertising, with some major exceptions. The communication sector’s largest holding is Alphabet, the parent of Google.

XLC’s industry groups include interactive media (Internet), entertainment, traditional media, and telecommunications.

**SPDR Consumer Staples (XLP)** include packaged-food companies, personal-care products, and cleaning supplies. Consumer-staple companies are non-cyclical. XLP’s largest holding is Procter & Gamble.

**SPDR Industrial (XLI)** includes manufacturing companies, providers of business services, and transportation companies. Industrials are highly cyclical and sensitive to changes in the economy. XLI’s largest holding is Union Pacific.
Industry and Sector ETFs

**SPDR Energy (XLE)** includes traditional oil and gas companies. Its members are highly cyclical and sensitive to changes in fossil-fuel prices. XLE’s largest holding is Chevron.

*This actively traded fund represents a smaller niche within the Energy Sector:*

- SPDR S&P Oil & Gas Exploration (XOP)

**SPDR Materials (XLB)** includes chemical makers and metal producers. Materials are mostly cyclical because they’re sensitive to changes in the economy. XLB’s largest holding is Linde.

*These actively traded funds represent a smaller niche within the Materials Sector:*

- Market Vectors Gold Miners ETF (GDX)*

**SPDR Utilities (XLU)** includes companies that deliver electricity, water, and natural gas. Utilities are non-cyclical, and among the most stable businesses in the economy. XLU’s largest holding is NextEra Energy.

**SPDR Real Estate (XLRE)** includes commercial real-estate companies like wireless-communications towers, warehouses, offices, apartment buildings, offices, nursing homes, and data centers. Its members are mostly non-cyclical and valued for their dividends. XLRE’s largest holding is American Tower.

* Gold miners are often viewed “safety plays,” making them a non-cyclical exception to other Materials companies.
Commodity ETFs

These ETFs are designed to track the price of physical commodities. While they mostly follow the direction of the underlying product, investors should be aware of potential risks in their structures. This is especially true when they hold futures contracts with different expiration dates.
These are the some actively traded commodity funds:

**SPDR Gold Trust (GLD)**
Tracks physical gold. Each share represents one-tenth of an ounce.

**U.S. Oil Fund (USO)**
Designed to track crude-oil prices.

**iShares Silver Trust (SLV)**
Tracks silver. Each share represents one ounce of silver.

**Note:**
Sector and industry funds like XLE (energy) and GDX (gold miners) are also sensitive to commodity prices because they own shares in producing companies.
Country and Currency ETFs

These ETFs track either foreign stock indexes or specific currencies. They were more popular between 2003-2012 because of stronger growth overseas.
These are the some actively traded commodity funds:

**iShares MSCI Emerging Market ETF (EEM)**
Mostly tracks Asian countries like Mainland China, Taiwan, and South Korea. It also has exposure to India and Brazil.

**iShares MSCI EAFE ETF (EFA)**
Mostly tracks developed countries like Japan and the U.K.

**iShares MSCI Brazil ETF (EWZ)**
Tracks Latin America's largest country.

**iShares MSCI FTSE/Xinhua China 25 ETF (FXI)**
Tracks Mainland Chinese stocks, mostly financials.

**KraneShares CSI China Internet ETF (KWEB)**
Tracks Chinese technology and e-commerce stocks.
Bond ETFs

These ETFs track bonds rather than stocks or commodities. That gives them interest-rate risk.
These are some actively bonds funds:

**iShares IBOXX High Yield ETF (HYG)**
Tracks non-investment grade securities, also known as “junk bonds.” These tend to be highly cyclical and follow the direction of equity markets more than other bonds. They have a greater risk of issuers going bankrupt.

**iShares Barclays 20+ Year Treasury Bonds (TLT)**
Tracks long-dated U.S. Treasury bonds. These can lose value when interest rates rise. They’re considered safe-havens without default risk and often move in the opposite direction as stock indexes.
Volatility ETFs

These ETFs track volatility indexes, which tend to rise at times of fear. These complex products are relatively popular but may not perform as anticipated. Investors should thoroughly study volatility ETFs before trading them. They’re mostly linked to futures on Cboe’s volatility index (VIX), which measures options prices on the S&P 500 index.
These are some actively volatility funds:

**iPath S&P 500 VIX Short-term futures (VXX)**
May gain at times of fear and lose value at other times as money is rolled between futures contracts. VXX has lost more than 99 percent of its value on a split-adjusted basis in the last decade.

**VelocityShares 2x VIX Short-term ETN (TVIX)**
A leveraged version of VXX intended for extremely short-term trading.
WHY ETF TRADERS CHOOSE

TradeStation has the tools and data you need to trade ETFs more effectively, including an award-winning trading platform, mobile app, and web trading, dedicated trading specialists, educational resources, and commission-free* pricing plans.

- Educational resources
- Trade-execution quality and price improvements
- Web and mobile trading
- Experienced customer support and trade-desk specialists

OPEN ACCOUNT

IMPORTANT INFORMATION

This document is intended for high-level information purposes only. The views expressed in this document are not investment advice or recommendations. The facts contained herein are not necessarily complete, and recipients of this document should do their own due diligence, including seeking independent financial advice before investing.

No offer or solicitation to buy or sell securities, securities derivative or futures products or account types of any kind, or any type of trading or investment advice, recommendation or strategy, is made, given or in any manner endorsed by TradeStation or any TradeStation affiliate, and the information made available on this Website is not an offer or solicitation of any kind in any jurisdiction where TradeStation or any TradeStation affiliate is not authorized to do business, including but not limited to Japan.

Past performance, whether actual or indicated by historical tests of strategies, is no guarantee of future performance or success. Active trading is generally not appropriate for someone with limited resources, limited investment or trading experience, or low-risk tolerance. Please click here for further important information, disclosures, and assumptions of risk.

TradeStation Securities, Inc., TradeStation Crypto, Inc., and TradeStation Technologies, Inc. are each wholly-owned subsidiaries of TradeStation Group, Inc., all operating, and providing products and services, under the TradeStation brand and trademark. You Can Trade, Inc. is also a wholly-owned subsidiary of TradeStation Group, Inc., operating under its own brand and trademarks. When applying for, or purchasing, accounts, subscriptions, products, and services, it is important that you know which company you will be dealing with. Please click here for further important information explaining what this means.

© TradeStation. All rights reserved.