

ETFs: What you need to know

Frequently Asked Questions

What is an ETF?

Exchange-Traded Funds (ETFs) are simply funds that are traded on the stock exchange and that follow the performance of an underlying asset such as an index - a "basket" of shares, bonds or commodities. By investing in ETFs, you have the opportunity to buy different securities or funds that follow the returns of different asset classes and markets, at a lower cost than if you had invested in them individually. By combining the various funds, with each other or with a traditional share portfolio, you can choose risk exposure based on your personal investment profile. The fund is constructed by the fund company buying the shares, or equivalent assets, that are part of a predefined index, e.g. OMX S30. The total holdings in the fund are divided into fund units or fund shares. The fund units are listed on the stock exchange. The fund company does not trade in the fund units itself, but these trades are mediated by brokers, appointed by the fund company, who have the right to create or redeem units in the fund. They do this directly with the fund company. These brokers (also known as Market Makers or Authorized Participants) are also tasked with setting the buy and sell price for the fund units listed on the stock exchange and to ensure that the price of these does not deviate from the fund's total share value or NAV (Net Asset Value).

How do ETFs work?

As an ETF tracks the performance of an underlying assets, buying an ETF gives investors a simple and cost-effective tool for getting exposure to the underlying securities. Instead of buying stocks in all companies included in an index, investors can gain access to those stocks with a lower risk. Investors can invest in many industries, companies or markets with the purchase of just one instrument.

What are the benefits of ETFs?

- Flexibility and transparency are two features that have added to the popularity of investing in ETFs. Compared to regular mutual funds which are usually traded no more than once a day, an ETF can be bought and sold on the exchange during the whole trading day, with market makers ensuring prices are available.
- ETFs are a cost-efficient investment. Most ETFs are passively managed, which means they track indices where the constituents or securities are predefined. As a result, they have a lower expense ratio than actively managed mutual funds—meaning you pay less to the managers of the fund itself.
- ETFs allow investors to buy diversified and professionally managed exposures to all sorts of assets without having to select the individual assets.

What are the risks of ETFs?

ETFs present many benefits but also involve risks. As with any investment product, investors should undertake their own due diligence and carefully evaluate financial instruments before investing.

What do I need to know before I start trading?

Before you start trading ETFs, it's important to understand how indexes are constructed and what exposure they have to a market or sector.

There are many broad indices that follow the returns of the largest companies in, for example, the USA, Europe, Asia or globally. They usually have very low management costs and good liquidity. There are also many narrow indexes that follow everything from the most traded companies in a specific country to a narrow sector in a developing country. As a general rule, they have a somewhat higher management fee, may be traded in a different time zone than the one you are in and therefore may have somewhat lower liquidity. Especially in the narrower indexes, it can be good to review which companies are included so that you get the market exposure you expect.

How to invest in ETFs in Sweden? How to trade ETFs?

Trading ETFs is as easy as trading stocks. You buy and sell them on the stock market, just like you buy and sell stocks. You place your order for the number of shares you want to trade via a bank or fund commission agent and the transaction is registered in your depository or your VP account.

You can also trade ETFs within the framework of an investment savings account, capital insurance or IPS depository. When buying and selling fund units, you pay a fee according to the price list that your bank or broker uses. Trading takes place between 09.00 and 17.25 in Sweden.

An advantage of ETFs is that you can buy or sell whenever you want during a trading day. In traditional fund trading, you typically trade at the NAV rate or the value the fund has at the end of the day, regardless of when during the day you sent your buy or sell order. With ETFs, you do not need to wait for the end of the day to have your order executed as pricing is handled by market makers or market guarantors who commit to setting buy and sell prices throughout the trading day. This is a big advantage for you if the market is turbulent and you want to quickly enter or exit the market.

Trading fees may make ETFs less suitable for monthly savings with smaller amounts because the fee then becomes disproportionately large and negatively affects the investment's percentage return.

It can be useful to compare the fees of the different issuers and brokers before deciding which funds or brokers to choose.

Are ETFs good investments? For which type of investors are ETFs most suited for?

Exchange Traded Funds suit active investors who have a firm understanding about trading in financial instruments and who want to benefit from changes in the market as easily and quickly as when buying or selling stocks.

What ETFs to invest in? What ETFs to buy?

It is always wise to formulate your personal strategy to be able to maximize the profit and spread the risks in a way that suits you. Your strategy should include both market and risk assessment, as well as the potential return you desire. Important aspects to take into account in all types of investments are:

- Purpose of the investment
- Investment horizon
- Risk profile
- Market perception
- Interest and time

If you have little time and are relatively risk-averse, it can be good to choose a few broad index funds as a base, which helps to diversify the risk. You may then consider increasing the risk and return potential with a smaller share of your capital by supplementing with more "exotic" ETFs, with exposure to commodities or a developing country. If instead you are less risk-averse, have more time to follow your investments and be more active in the market, you may consider increasing the share of funds with more exotic exposures or trade ETFs with leverage.

How to evaluate ETFs?

For a private person, the cost is probably the most relevant aspect to consider once a decision on target market has been made. Management fee and transaction costs are relevant for this evaluation. Different issuers have different fees for more or less the same exposure. Also transaction fees may vary between different brokers.

How is an ETF different from a stock?

For index ETFs which are the most common ETFs, they are funds that are traded on the stock exchange and that follow the performance of an underlying asset - an index. Stocks (or shares) represent an ownership interest in a single company. By investing in ETFs, you have the opportunity to get exposure to a range of different securities, industries, geographies or markets through a single transaction as opposed to investing separately in, for example, each share that makes up the OMXS30 index.

How is an ETF different from a mutual fund?

The main difference is that an ETF is traded throughout the day on the exchange while a mutual fund is typically traded once per day at the Net Asset Value (NAV) price. In especially volatile markets with rapid price movements, ETFs offer clear advantages from this perspective as the investor does not need to wait until the end of the day for their order to be eligible for execution.

How is an ETF different from an index fund?

A passively managed ETF is an index fund. There are passively managed mutual funds and the main difference is that an ETF is traded throughout the day on the exchange while the mutual fund is traded on an end-of-day NAV price. In especially volatile markets with rapid price movements, the ability to trade only once per day could be considered a clear advantage of ETFs.