THE STOCK MARKET GAME™

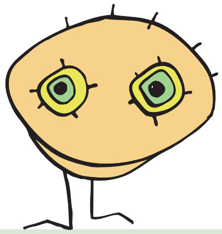
Stock talk

Emily & ETF

by Bill Dickneider

One day after school Emily was at home researching stocks on the web. She came upon an unfamiliar investment called exchange traded funds. "What in the world are they?" she said aloud to herself.

"How about Spiders, Vipers, or Diamonds?" asked a little figure that suddenly popped up on her screen.



Here are some funds to check out on the Web. Go to www.amex.com and click on ETFs. Then choose "List All Products" from the pull-down menu at the right.

Cubes (QQQQ) The Nasdaq 100 Trust follows the Nasdaq 100 index

DIAMONDS (DIA) – Shares of the DIAMONDS Trust follow the Dow Jonres Industrial Average.

iShares – About 100 different funds following a variety of stock indexes. A few follow bond indexes.

Spiders (SPY) – Standard & Poor's Depositary Receipts follow the S&P 500 stock index. Select Sector SPDRs follow sectors that are part of the S&P 500.

VIPERS – Vanguard Index Participation Receipts. More than 20 different funds that follow various stock indexes.

Funds Like Stocks

Emily had seen pop ups on the web before, but never had one tried to start a conversation with her. This is weird, she thought, but Emily was curious and decided to respond. "I might want diamonds in my portfolio but not spiders or vipers," she said.

"Well, Emily, you might change your mind once I explain an exchange traded fund," said the little figure,

"What should I call you?" asked Emily, wondering how the figure knew her name.

"ETF," it said. "Just call me ETF. I hate to be abrupt, but I can't stay long. So let me explain this type of investment. An exchange traded fund is an investment company whose shares are listed on an exchange and trade during the day just like a stock. The fund is a basket of stocks or bonds that match a particular index. So your investment would follow the ups and downs of the index tracked by the fund."

"Can you give me an example?" asked Emily.

"Spiders are an example," said ETF. "They're really spelled S-P-D-Rs, which stands for Standard & Poor's Depositary Receipts. When SPDRs began trading in 1993, they were the first exchange traded fund. The fund invests in stocks that match the S&P 500 – the Standard & Poor's index of the 500 largest companies."

"That's a humongous Spider," said Emily. "If I buy a share of the fund, would I own a tiny part of each of those companies?" she asked.

"Yes," answered ETF. "That's called diversification. There also are other Spiders that let you select different sectors of the S&P 500. There's an Energy SPDR or a health-care SPDR, for instance."

You also mentioned Vipers and Diamonds. What about them?" asked Emily.

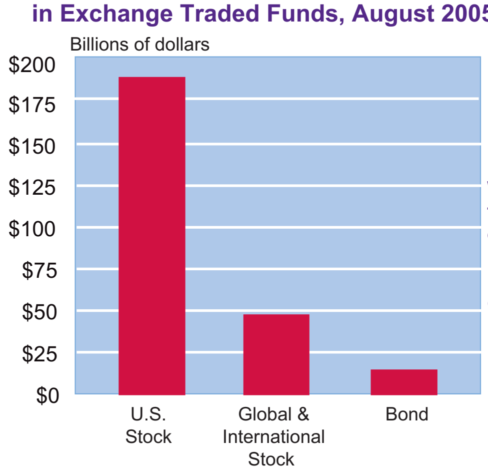
"Here, take a look at this," said ETF, while showing Emily the list shown on the first page. "There are now close to 200 different exchange traded funds, and investors are putting more savings in them every year.

"I've learned a little about mutual funds while playing The Stock Market Game," said Emily. "They're also called funds, so aren't they really the same as exchange traded funds?"

"They're similar but not identical," said ETF. "Mutual funds have been around for more than 75 years, and they've become very popular with investors. There are nearly 8,000 mutual funds today in which people have invested about $8 trillion of savings – about 40 times the amount invested in exchange traded funds."

Exchange Traded Funds	Mutual Funds
You pay a broker's commission for each trade.	Investors can buy directly from mutual funds without paying commissions.
No minimum amount that must be invested when buying shares.	Minimum investments usually required. These amounts are sometimes substantial.
Nearly all funds are index funds that buy just the stocks or bonds that make up a particular index. As a result, the portfolio is not actively managed and expenses are usually very low.	Some funds are index funds, but most are actively managed by professionals who pick the stocks or bonds to buy.
Shares can be traded at any time during the market's trading hours.	Orders can be placed any time during the day but are completed only at closing prices after the market closes.
Very few funds that focus on bonds or investments that don't have a big following and may therefore be difficult to trade. So you may not be able to put together the well-rounded portfolio you seek.	Many funds specialize in bonds or in investments without a big following that can be difficult to trade. So you can often put together the well-rounded portfolio you want.
Usually no automatic reinvestment of dividends that companies pay.	Dividends can be automatically reinvested.
A share's price might be above or below the fund's net asset value (value of stocks and bonds in fund divided by the number of fund shares).	A share's price is equal to the fund's net asset value.

Amount of Shareholders' Investment in Exchange Traded Funds, August 2005



Source: Investment Company Institute, www.ici.org

What was shareholders' total investment in exchange traded funds in August of 2005? Use the chart to calculate the amount.

"Both types of investments are called funds because they pool savers' money and invest it in mixtures of stocks or bonds," continued ETF. "But there are many important differences between mutual funds and exchange traded funds. I've already explained that exchange traded funds trade during the day just like stocks. Mutual funds don't. But there are other differences, too. Take a look at this, said ETF, pointing to the list above that appeared on Emily's computer.

Emily carefully read the list. Then she thought about the advantages and disadvantages of exchange traded funds. When she looked back at her computer, she noticed that ETF was gone. She couldn't explain the mysterious appearance and disappearance of the little figure. But she was grateful for its unusual introduction to the world of ETFs.

Write Now

Pick one of the following and write a paragraph to explain your answer.

Suppose you started a savings program and wanted to find some good long-term investments. Would you consider exchange traded funds?

Exchange traded funds are index funds. What does that mean, and why does indexing usually result in low fund expenses?

StockTalk instills an understanding of saving and investing by defining investment and stock market terms through application and demonstration in a fictional setting. StockTalk is published by the Foundation for Investor Education for The Stock Market Game™ Program.