

ETFs and ETCs...

what are they and how can you invest in them?

Buying and selling Exchange Traded Funds or Exchange Traded Commodities is as easy as trading ordinary shares and can be quicker and cheaper than buying comparative funds or trusts.

Exchange Traded Funds (ETFs) and their close cousins Exchange Traded Commodities (ETCs) are often used by investors as an easy way to track a stock market or a particular sector or commodity. They are open-ended investment funds that are listed and traded on stock exchanges throughout normal trading hours in the same way as ordinary stocks. Benefiting from market maker support and guaranteed liquidity, they're cost-efficient too as they typically have low management charges and no stamp duty is charged on purchases.

Exchange Traded Funds

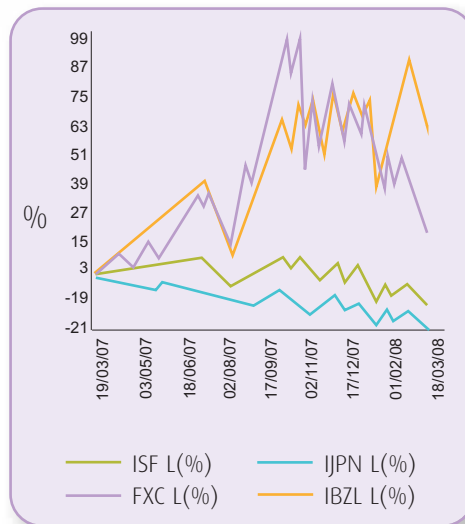
What are they?

ETFs inherently diversify risk and have experienced a rise in popularity in recent times as investors seek a 'safer haven' to investing in individual equities. They provide an easy and convenient way of tracking the markets and can spread investment risk across selected markets or sectors.

Popular in the US, in recent years ETFs have accounted for almost 60% of new money in the retail market, according to Barclays Global Investors. In the UK they are still an emerging market and only comprise 15-20% of investments. However, their popularity is rapidly growing as advisers are increasingly adopting them as part of their asset allocation strategies.

Most popular ETFs purchased through The Share Centre

- iShares FTSE Bric 50 (BRIC)
- iShares FTSE 100 (ISF)
- iShares FTSE/Xinhua China 25 (FXC)
- iShares MSCI Brazil (IBZL)
- iShares FTSE UK Dividend Plus (IUKD)
- iShares MSCI Japan (IJPN)



Source: Proquote

fact the index has lost over a third of its value since July 2007. This could be due to the lack of foreign investment on which Japan has historically depended. Foreign investors used to account for nearly 60% of trading on the Nikkei, but as these investors have moved on the market decline has magnified.

The IBZL has been particularly popular, both with investors looking for exposure to emerging markets and because of its large oil and other natural resources potential.

Exchange Traded Commodities

What are they?

ETFs that invest in commodities are known as Exchange Traded Commodities and bear similar characteristics to ETFs. As the name suggests, the difference is that they track the performance of an underlying commodity index or an individual commodity. With ETCs, investors can gain access to a wide variety of commodities from oil to coffee, gold to corn and cotton to soybeans. They also carry a higher risk profile than ETFs because an ETC is largely an individual commodity, whereas an ETF will contain many holdings due to the indices they are tracking. However, they have recently been producing high rewards relative to more traditional investments.

ETCs enable investors to gain exposure to commodities without trading futures or taking physical delivery – risks that prior to ETCs made investing in commodities difficult for individual investors. They are governed by different rules and have a higher risk profile than ETFs. The FSA considers ETCs to be a complex instrument, due to the risk profiles of the underlying commodities (e.g. Wheat, Cotton, Gold, and Silver). This asset class is therefore not for the faint hearted,

Past performance

The above chart shows the closing mid-prices: percentages shown are gross and do not take account of any charges associated with buying, selling or holding ETFs. It represents the one year performance (March 2007 – March 2008) of some of the ETFs available through The Share Centre. Both the ISF that tracks the FTSE 100 and the IJPN that tracks the Japan markets have underperformed compared to the FXC and the IBZL that track the China and Brazil markets respectively.

Those that invested in the FXC prior to its peak could have taken advantage of the Chinese economy's wonderful journey that has benefited from both financial investment and hype in the preceding two years. However, in the last six months the FXC has seen dramatic falls in response to major concerns about the markets, the lack of sustainable growth and sub-prime issues.

However, the Far East is no guarantee of success as shown by the performance of the IJPN. This is one of the few ETFs that have underperformed the ISF and in

as sudden swings in worldwide demand have an immediate impact on the share price. New potential ETC Investors (since November 2007 when the FSA rules changed) are therefore required to pass an 'Appropriateness Assessment'.

Media stories highlighting the increase in price and demand for metals and soft commodities have stimulated investors' interest in recent months in these new and previously unavailable investments.

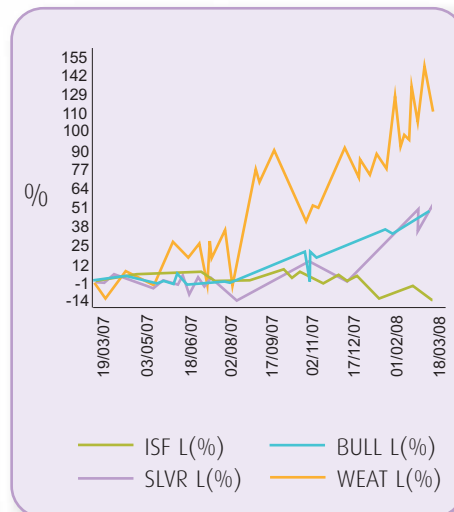
Past performance

The chart shows the closing mid-prices: percentages shown are gross and do not take account of any charges associated with buying, selling or holding ETCs. It represents the one year performance (March 2007– March 2008) of some of the ETCs available through The Share Centre. It can clearly be seen that the WEAT that tracks Wheat has had substantial growth over the last year. The BULL that tracks Gold and the SLVR that tracks Silver have also outperformed the ISF that tracks the FTSE 100.

Gold has continued to be a popular investment as it has always been seen as a safe haven. So much so, that we recently saw the price of gold break through the \$1000 per ounce barrier in response to market turmoil. Some analysts think the price has further to rise. Silver is on a similar upward curve.

Agriculture has proved a successful and popular area for investment over the last year. Its growth is heavily influenced by the rise in wheat prices driven by the global shortage of wheat – due to adverse weather conditions – and the increased demand for wheat in response to rising populations and increased personal wealth. China has been at the forefront of this increase: as personal wealth has increased, there has been a corresponding increase in the demand for meat – for each additional 1kg of meat produced, 7kg of wheat is required.

However, one of the most popular and profitable trackers has been that of the PHPT that tracks Platinum, a relatively new ETC (available since 24 April 2007), which is not shown on the graph. Its success is driven by the demand for new cars – Platinum is the main component in the manufacture of catalytic converters – relative to its availability. It has strongly outperformed the ISF and over the last four months has grown by approximately 50%.



Source: Proquote

The benefits:

- Prices are updated continuously during the trading day and they can be bought and sold throughout the trading day, thereby providing instant exposure to a portfolio of market indices and sectors.
- Possible lower investment risk through inherent diversification.
- Easy to track online and their performance is listed in the financial section of quality daily and financial newspapers.
- As they are open-ended securities, new units can be issued in response to demand. Consequently, the trading price of an ETF roughly equates to the trading value of the underlying securities held in the fund plus any undistributed net income.
- No redemption fees to pay, although brokerage commissions will apply.
- Tax efficient: their structure supports the deferral of capital gains tax until final disposal.
- Low management costs compared to other pooled investments, typically under 0.5% of the fund's value.
- No stamp duty to pay on purchase (duty will have already been paid on the underlying investments where applicable).

The risks:

- Many are specific to one region or market, therefore external political factors may be needed to be taken into account.
- As they are shares you could lose all your investment.
- ETFs and ETCs are fairly new and have not really been 'battle-tested' yet.
- ETF Securities Ltd, the leader in ETCs is also a relatively new company; however, they do state on their website that if they

Most popular ETCs purchased through The Share Centre

- Commodity Securities Ltd ETFS Agriculture (AGAP)
- Commodity Securities Ltd ETFS Gold (BULL)
- Commodity Securities Ltd ETFS Grains (AGGP)
- Commodity Securities Ltd ETFS Silver (SLVR)
- Metal Securities Ltd ETFS Physical Gold (PHGP)
- Metal Securities Ltd ETFS Physical Silver (PHSP)

ceased trading, the value of the ETCs they issued would not be affected.

- To the extent they are traded in other countries, their value may be affected by exchange rate movement.

More useful information on ETFs can be found on the ETF Securities Ltd website at www.etfsecurities.com.

Investing in ETFs/ETCs

If you're not sure where to start take a look at our ETFpicker in the Research section of our website at www.share.com. It allows you to filter available ETFs and ETCs according to:

- **Country or region** – UK, US, Europe, Far East, Emerging Markets.
- **Asset type** – Commodities, Equities, Gilts/Bonds, or by Property.
- **Risk** – Low, Medium or High.

Please remember that past performance is no guide to future performance and you could realise less than your initial investment.

Interested?

You can buy and sell ETFs online via our website. You can also buy both ETFs and ETCs through our Dealing team who can be contacted on 01296 41 42 43. ETFs can be held in either a Share Account, a Stocks & Shares ISA, a non-stakeholder Child Trust Fund or a Self Invested Personal Pension. Remember that in order to buy ETCs you will need to pass an Appropriateness Assessment.