Scarlet Oak Financial Services
Faye Sykes, CLTC, NSSA
CEO & Independent Advisor
1117 Perimeter Center West
Suite W-212
Atlanta, GA 30338
800-871-1219
fsykes@scarletoakfs.com
www.scarletoakfs.com

Basic Strategies with Exchange-Traded Funds

Basic Strategies with Exchange-Traded Funds

Investing in a sector rather than an individual stock

In some cases, you may believe in the future of a specific industry, but have concerns about investing in a single stock in a rapidly evolving field. If you're interested in a sector but don't want to commit your entire investment to one company, an ETF that is based on a relevant index can help spread your risk within that sector. Diversification doesn't guarantee a profit or ensure against a loss, of course--the sector itself may be quite volatile or cyclical--but an ETF allows you to make a sector bet without relying on the fortunes of an individual company.

Overweighting a particular strategy or sector

Even investors who hold one or more broad-based stock funds--for example, one that focuses on the S&P 500--sometimes want to emphasize stocks that are strong on some aspect of their fundamentals, or that are in a specific industry. Depending on the index it tracks, an ETF can boost exposure to only those stocks.

Example(s): *Joe likes to keep his investing simple, so the bulk of his stock portfolio is in an ETF that tracks the Wilshire 5000, which includes virtually all publicly traded U.S. equities. However, as he nears retirement, he is beginning to like the idea of focusing on larger, dividend-paying stocks. He decides to sell one-quarter of his Wilshire-based shares and use the proceeds to buy an ETF based on an index that selects and weights stocks according to their dividend yield.*

Staying invested after selling stock for a tax loss

ETFs can help you maintain exposure to a specific sector of the market after selling a stock. For example, you may have sold a large stock position to realize a capital loss for tax purposes, but still believe the industry as a whole is in for some short-term upward price movement. However, if you buy the stock again within 30 days, you would be unable to take the tax loss, because the two transactions would be considered a wash sale.

Purchasing an ETF based on a relevant index is one way to attempt to participate in any industry-wide volatility. In essence, the ETF serves as a proxy for your former investment until you are able to buy it again if you choose to.

Example(s): *Bonnie expects to owe a large capital gains tax bill this year, so she plans to sell at a loss the shares she bought in XYZ Corp, a small biotech firm that has seen better days. However, the government has recently announced a large research program that she expects may spark renewed investor interest in the sector. She sells her XYZ shares and invests the proceeds into ABC Fund, an ETF that tracks an index of biotechnology firms. Thirty-one days later, she can either continue to hold her ABC shares, invest again in the original company, or invest in other individual stocks.*

Minimizing taxes

ETFs can be relatively tax-efficient. Because a passively managed ETF trades so infrequently, it typically distributes few capital gains during the year. In some cases, investors found themselves paying taxes on capital gains generated by a mutual fund, even though the value of their fund actually may have dropped. Though it's not impossible for an ETF to have capital gains, ETFs generally can minimize the ongoing capital gains taxes you'll pay.

Just how much impact can reducing taxes have over the long term? More than you might think. Even a 1 percent difference in your return can be significant. For example, if you invest $50,000 and earn an average annual return of 5 percent (compounded monthly), you would have a pretax amount of $82,350 after 10 years. Even a 1 percent increase in that return would give you $90,970 at the end of that time.

Tip: *Make sure you consider just how an ETF's returns will be taxed. Depending on how the fund is organized and what it invests in, returns could be taxed as short-term capital gains, ordinary income, or even (in the case of gold and silver ETFs) as collectibles, all of which are taxed at higher rates than long-term capital gains.*

Using ETFs to reduce expenses

Because they're not typically actively managed, ETFs usually have relatively low expense ratios. As a result, they can be an effective way to minimize long-term investing costs, especially if you have a lump sum to invest and don't plan to trade frequently.

Attempting to profit from market timing

Some investors use ETFs to trade in and out of a particular sector rapidly. And because ETFs can be shorted just as an individual stock can, you can use ETFs to act on a belief that the overall market is likely to drop.

Limiting losses

Being able to set a stop-loss limit on your ETF shares can help you manage potential losses. A stop-loss order instructs your broker to sell your position if the shares fall to a certain price. If the ETF's price falls, you've minimized your losses. If its price rises over time, you could increase the stop-loss figure accordingly. That lets you pursue potential gains while setting a limit on the amount you can lose.

Caution: *Before investing in an exchange-traded fund, carefully consider its investment objectives, risks, fees, and expenses, which are discussed in the prospectus available from the fund. Read it carefully before investing. All investing involves risk, including the possible loss of principal, and there can be no guarantee that any investing strategy will be successful.*

To schedule an appointment with Faye Sykes, click here .

Broadridge Investor Communication Solutions, Inc. prepared this material for use by Scarlet Oak Financial Services.

Broadridge Investor Communication Solutions, Inc. does not provide investment, tax, legal, or retirement advice or recommendations. The information presented here is not specific to any individual's personal circumstances. To the extent that this material concerns tax matters, it is not intended or written to be used, and cannot be used, by a taxpayer for the purpose of avoiding penalties that may be imposed by law. Each taxpayer should seek independent advice from a tax professional based on individual circumstances. Scarlet Oak Financial Services provide these materials for general information and educational purposes based upon publicly available information from sources believed to be reliable — we cannot assure the accuracy or completeness of these materials. The information in these materials may change at any time and without notice.

Scarlet Oak Financial Services outgoing and incoming e-mails are electronically archived and subject to review and/or disclosure to someone other than the recipient. We cannot accept requests for securities transactions or other similar instructions through e-mail. We cannot ensure the security of information e-mailed over the Internet, so you should be careful when transmitting confidential information such as account numbers and security holdings. If the reader of this message is not the intended recipient or an employee or agent responsible for delivering this message to the intended recipient, you are hereby notified that any dissemination distribution or coping of this communication is strictly prohibited. If you have received this communication in error, please notify us immediately by replying to this message and deleting it from your computer. Advisory Services offered through Capital Asset Advisory Services, LLC., a Registered Investment Advisor.

Scarlet Oak Financial Services
Faye Sykes, CLTC, NSSA
CEO & Independent Advisor
1117 Perimeter Center West
Suite W-212
Atlanta, GA 30338
800-871-1219
fsykes@scarletoakfs.com
www.scarletoakfs.com

scarlet·oak·financial·services