

explainity explains: ETF

Michael owns a lemonade factory. He went public with his “Zitrus” company ten years ago and recently began trading in the worldwide fruit ETF. ETF stands for “exchange-traded fund.” For people like Susanna, it’s an opportunity to invest their money.

An ETF pools together several investment products from a sector and tracks their index – that’s the average market value of all products. There are ETFs for the stock market, bonds, raw materials and even real estate. Some only cover sustainable or social investments. Others encompass specific regions or several countries. There are ETFs for specific sectors, like transport, industry, technology and even the food sector, like our fruit ETF example. It includes the top thousand economically strongest companies in the fruit industry, such as Mickey’s Zitrus company.

ETF shares are, like stocks, purchased and sold on the stock exchange. So, Susanna could spend a lot of money and buy shares in each of these fruit companies. Or she could spend less money and buy a fruit ETF, which means her investment is spread proportionally across all the assets within it. The index of all the individual stocks and the performance of the ETF pool are therefore almost identical. If the market price drops, then so does the ETF market price and vice versa.

When you invest in an ETF, it’s also called a **passive investment**, as unlike funds, ETFs are not **actively** managed. Instead, they are mostly run automatically. So, with a fruit ETF, Susanna also pays fewer fees than with an actively managed fund investment.

The downside of an ETF: should the market price of one product drop significantly, it might take a while for the system to detect this loss in value and adjust the ETF. With an actively managed fund, a funds manager steps in more quickly and can replace the worse asset with another product, for example.

Usually an ETF includes a lot more assets than a fund. So when the value of one company drops, this loss can be offset by the market prices of other companies in the ETF – and so, the drop is barely noticeable.

On top of this, Susanna can see which assets are included in the ETF at any time. It’s possible to invest just a small, one-off amount or, with a savings plan, as little as 25 euros a month. ETFs can be traded daily, and there’s no minimum duration.

But watch out! As with all investments, even with ETFs, Susanna must anticipate the many risks involved and do her research before investing her money.

In any case, Mickey’s happy that his Zitrus company is being traded in an ETF - and with the success of his once-small juice shop.

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