# EXCHANGE TRADED FUNDS (ETFs)

Qatar Stock Exchange offers a platform for Exchange Traded Funds. ETFs, as they are commonly known, are open-ended, index-based funds, traded intraday, offering broad exposure across developed, emerging and frontier markets, equities, fixed income and commodities.

## WHY INVEST IN ETFs?

ETFs provide investors with the ability to buy and sell individual units, just like shares, of a fund which is designed to mimic a particular asset class or market sector. This allows investors to enjoy the benefits of asset diversification, without the associated costs of building the portfolio themselves. Examples of these ETFs are those which track an index, or those that track the price of a specific asset. The Fund Manager invests the fund subscriptions in the appropriate securities or products so that each unit has a fractional ownership of those assets. For an Index ETF, this means that each unit will have a fractional holding of all of the shares, in the correct proportions, which are constituents of the index.

ETFs are widely used by institutional investors and increasingly by financial advisors and retail investors to:

- Achieve passive exposure according to preferred investment strategies.
- Diversify – allowing  investors big and small to build institutional-caliber portfolios.
- Gain convenient access to markets that would otherwise be difficult to invest in.
- Implement tactical adjustments to portfolios.
- Deploy cash – be ‘fully invested’ and benefit from directional trends.
- Allow investors to hedge the market.

## CHARACTERISTICS OF ETFs

ETFs listed on Qatar Stock Exchange can be bought and sold like shares throughout the trading day. Individual investors may purchase or sell an ETF via their broker, and may enter the same types of orders that are placed for shares. Investors have full transparency of the underlying portfolio of intra-day priced assets, with holdings disclosed on a regular, frequent basis.

ETFs have the lowest expenses ratio among registered investment products and are cost efficient because in one execution an ETF allows investors to trade all components of the underlying index

Competitive bid/ask prices are provided by Licensed Liquidity Providers whose role it is to interact with the Fund Manager in the primary market and maintain the supply of units in the secondary market, the Exchange.

## HOW ETFs WORK

Unlike shares, an ETF can “create” new units or redeem existing units on any trading day. These “creation” or “redemption” processes are reliant on the relationship between the Fund Manager and a Licensed Liquidity Provider who can exchange the appropriate portfolio of shares or assets with the Fund Manager and receive ETF units (“creation”), or can “redeem” ETF units and receive the appropriate securities or assets in return.

Both creations and redemptions occur at the Net Asset Value (“NAV”), which is calculated based on the total assets of the ETF, subtracting expenses and dividing by the number of ETF units outstanding. The NAV is calculated after the close of each trading day and is made available to the public by around 4PM. During any trading day, the price of the underlying components change, an indicative NAV, or iNAV, is calculated and published by the exchange.

The market price of an ETF is often closely related to its NAV or iNAV, but there is no guarantee or assurance that an ETF unit will always trade on the exchange at a price that is equal to its intrinsic or fair value. At times an ETF may trade at a premium to or at a discount to the NAV (due to illiquidity in underlying components, for example). However, the ability of the Licensed Liquidity Provider to create and redeem ETF units (undertaking arbitrage) will help to keep the ETF's price in line with its fair value.

Fund managers will charge fees that are deducted directly from the assets of the ETF. This can result in the investment return of the ETF being lower than that of the underlying benchmarked index or asset. These fees are referred to in the prospectus by such terms as an "expense ratio", "management fee", or "investor fee". They are usually expressed as an annualized percentage. The fund management fees are included in the daily published NAV and will therefore be incorporated in the bid and ask prices quoted on the exchange. It is important to refer to an ETF's prospectus for details on fees and how they are calculated. Because ETFs trade like shares, brokerage commissions and other transaction costs will also apply to ETF purchases and sales.

Though ETFs are designed to mimic the price and yield performance of their respective underlying index or asset, there is the possibility of the fund manager not 100% replicating the performance of the underlying because of fund expenses or other factors. This is referred to as "tracking error".

## INCOME FROM ETFs

An ETF may distribute any net investment income that the fund earns in the form of a dividend. A fund's net investment income is earned from receiving dividends and/or interest payments from the fund's holdings, less the fund's expenses. Until a potential payout date, income awaiting distribution is included in the fund's daily NAV. All shareholders who hold units of a fund on the record date are eligible to receive any potential distributions.

Alternatively, an ETF may reinvest any dividend and/or interest payments proportionately across the underlying basket. Underlying indices that employ this methodology are known as 'total return' based. So long as income is efficiently reinvested, performance should be enhanced by the compounding effect of reinvestment.

## ETFs COMPARED WITH MUTUAL FUNDS AND SHARES

| Features | Exchange Traded Fund | Mutual Fund | Share |
|---|---|---|---|
| Diversity | ✔ | ✔ | ✘ |
| Liquidity | ✔ | ✘ | ✔ |
| Transparency | ✔ | ✘ | ✔ |
| Flexibility | ✔ | ✘ | ✔ |
| Low Cost | ✔ | ✘ | ✔ |
| Ability to track index | ✔ | ✔ | ✘ |

It is important to read the prospectus and product description carefully and research the product before investing in an ETF to ensure that the risk, exposure and income characteristics are consistent with your investment goals, risk tolerance and portfolio. The level and type of risk associated with ETFs may vary significantly from one ETF to another. It is important that you understand the underlying benchmark or portfolio of securities that the ETF is designed to replicate in order to evaluate the risks of investing in that ETF. You should also consider consulting with your investment adviser or broker before making the decision to invest.