

TRANSCRIPT

New to ETFs? 5 must-ask questions to get started

Presenters: Jonathan Lamothe and Heather Knight

Jonathan Lamothe: Hello everyone and welcome to our webinar today, New to ETFs, five questions to get started. My name is Jonathan Lamothe, I'm here in educational events at Fidelity.

Today I'm joined by Heather Knight, a brokerage consultant here at Fidelity Investments. Her main job is to help educate clients like yourselves in all things brokerage; trading, education, research, all that stuff so she's one of many experts we have here. But today Heather and I are going to dive into the world of ETFs so you can become a better, more confident and diversified investor.

So, I know Heather we've got a whole lot to get through today, what do you say we get it going? I want to welcome you and how you doing today?

Heather Knight: I'm doing good, Jonathan. Thanks for having me joined today, certainly an exciting topic. And as we know, we've done a lot of these webinars together, and what we find is there's so many clients having questions about ETFs, so it's pretty exciting today to be able to get down to it

and share some interesting information and do some demos today with everyone.

Jonathan Lamothe: Well, I'm so happy you're super excited to do this with us today.

There's going to be a lot of information here, we're going to go through a few of the basic things with ETFs just for our audience and for you, Heather, and then we're going to dive into hopefully some actual questions that have come through that little slider widget I mentioned earlier. So, first question, Heather, a lot of people when they talk about ETFs, they hear the word "index." So, I'm wondering if you could tell me what is an index -- I'm going to bring up the question here -- what is an index and why is it important in this conversation?

Heather Knight: Yeah, so it actually is, like you said, one of the number one

questions that a lot of clients ask. So, you know, an index is actually a specific measurement -- actually a measurement of financial market or a segment of a market. So, some of the common examples that we're used to are like the Dow Jones industrial average, so that's the 30 major U.S. owned publicly traded companies like 3M, Exxon, Mobil, Apple, Johnson & Johnson. And then also, the S&P 500, right, that's the big one, the common one that we think. And of course, the NASDAQ, and that one actually tracks the NASDAQ Stock Exchange. And then the Barclays U.S. Aggregate, that would be another one. So, those are major indexes, but overall, it's actually a specific measurement of the financial market or a segment of that particular market.

And these are the major ones that we refer to when we're thinking about starting the process with the exchange traded funds.

Jonathan Lamothe: So, while we're on this slide, Heather, do each ETFs just track indexes, or are there other ETFs available?

Heather Knight: Wow, that's a good question too, actually. You know, most ETFs track indexes, right. So, there are some products, though, that hold physical commodities, it might be considered unit investment trusts or maybe even their bank-issued debt like exchange traded notes. There's a lot of broader ranges that you'd find when you're looking at trying to use an ETF as part of your overall strategy or your portfolio. Sometimes we refer to them, even here at Fidelity, as ETPs or exchange traded products. And I kind of think of that as the big world of the choices, and then of course ETFs underlying.

Also, you might hear the term -- and this is relatively new where I know that we're using this as well -- as exchange traded vehicles, right. So, that really again encompasses, hey listen, there might be different types of ETFs out there and they might track different things, and they might actually hold different types of securities. So overall, that's why we want to make sure that we take a look at the underlying components, and of course, read the composition and understand really what the ETF is meant to do.

And I encourage anybody who's been an ETF investor for years over years to revisit your current holdings too, compare them -- and we'll talk about how you can do that today -- and make sure that you're still invested the way that you want to be as part of your strategy. Because, you know, as the years go by -- and you know this too, Jonathan -- we've just continued to surpass what we could ever have thought in the world of exchange traded products overall. And so, now that we see things and newer ones that are coming out, we certainly want to be apprised of what's available out there and there might be better ones that might suit our needs. So, it's always important to double check your current list of exchange traded funds and compare them and make sure you're still in the same investment vehicle that's right for you.

Jonathan Lamothe: So, Heather, you mentioned a whole bunch of cool vocabulary words that we're going to get to later in the presentation here. So, what if we take it to the next level here and let's just talk about what exactly an ETF is, maybe in, you know, the simplest terms.

Heather Knight: Yeah, so basically, an ETF is a basket of securities that's designed to offer exposure to certain segments of the marketplace. And I kind of mentioned before, they use different types of asset classes. So, you heard me say, you could hold commodities, you could be tracking futures, or could be all different types of underlying components. There are just so many different exchange traded funds, but overall, it's a basket of securities typically

designed to give you exposure to a specific segment or area of the marketplace.

Jonathan Lamothe: So, you say basket of securities and I know from my perspective, I've gone on, you know, different sites and looked at securities that all have similar names and similar, you know, you think holdings. Are ETFs that track the same goals fundamentally the same or, you know, how can you tell the difference there?

Heather Knight: Yeah, here's the thing: not always, right. You have to look underneath the hood of an ETF. I think we've heard this before amongst not even just Fidelity, but even some of the firms that we partner with, you know, you've got to understand truly what's inside of your exchange traded funds. So, to answer your question, I mean, you could have a name of an ETF state that it might be tracking something similar like S&P 500 for example, we'll go kind of basic, and does it truly track the S&P 500 exactly to the waiting, or is this an equal weight type of an exchange traded fund?

So, something that actually holds underlying components that are equal weight across the board. So, while it might say that it's a S&P 500 ETF, we still need to actually look a little bit deeper under the objective. And then for me, I like to look at the holdings, right. I really like to see what's in there and sometimes, especially as we continue forward, it may not be as transparent,

but overall, I can see that diversification and I also can read the benchmark or the underlying index that it's actually tracking depending on the type of ETF and know is this the right thing for me.

Again, you know, something as simple as saying hey, listen, this could be a market cap or this could be exposure-meeting, you know, it's based on an exact replication or a replication of the underlying index in the case of the S&P 500, or there might be an S&P 500 ETF that's, like I said, equal weight. So, rather than it matching the index, maybe each one of them are actually equal weighted, the underlying securities that are inside of the ETF are equal weight across the board.

So, how do you find that? You have to look underneath; you've got to do a little bit more research. Don't just go by the name; we want to make sure that we understand the objective and take a look at the percentages of the underlying holdings on some of those ETFs as well.

Jonathan Lamothe: You know, the example we always use, Heather, is when we look at oil in particular, a lot of ETFs have the word "oil" in their description or their name and you find out, once you do some of the diligence there and look at what they're actually holding, very few actually hold physical oil; they're much more broken down than that, but you just assume, you hear the word.

Let's move on here and let's talk about some of the strengths and weaknesses of ETFs.

Heather Knight: Absolutely. So, I think, you know, we always air on the side and you see this here, the strengths of the ETFs. So, yeah, we will definitely talk about both. But overall, while I think I could probably give you a list of a hundred pros and maybe even similar equals to cons, the first thing is, is it really has to come down to you as an investor and what your goals are, right, and how you're going to use ETFs to fit into your portfolio.

But bottom line is, when I think about ETFs overall and I'm talking about them, the diversification, number one, right. So, you can meet those asset allocations by purchasing ETFs that track, for example, financial services indexes, or you can actually take a look at specific sectors or industries within financial services. Maybe you have a gap in your overall portfolio and you're not really sure how to invest.

Or maybe a lot of times from, you know, that I've worked with clients, they may have had a super concentration of one stock; maybe it's appreciated over, you know, a 5, 10 years' standpoint. And they're trying to take advantage of maybe still being invested -- and I'll use that example again, financial services - in the financial services so maybe they have a stock that's specific to banking and they want to sell a little bit out of it every single year, could be scaling out.

You know, obviously you have to make sure that it makes sense for you, but they want to invest back in that same sector industry. So, instead of having one stock, they might take a look at buying an exchange traded fund which would give them exposure to multiple stocks that make up that particular sector or industry level.

So, diversification is huge. You know, it gives you the ability to actually not put essentially, I guess, all your eggs in one basket or one stock, but still gives you the exposure that you might be looking for. So, that's one of the best things, I think, about ETFs. And a lot of clients tend to use ETFs even for a holding place, right. So, they're waiting to get that exposure.

The next one I'd talk about it is transparency. And I've got to say to you, you know, over the years the transparency is changing a little bit. I mean, there are certainly some ETFs that are not as transparent anymore, and there's nothing wrong with that, it's just the evolution of exchange traded funds. But specifically, for most ETFs, they reveal their holdings on a daily basis or a nightly cycle. So, you know what's in your ETF on a daily basis.

And so, a lot of times, you know, when we think about a mutual fund -- and I know we're going to do a little comparison because that's always a big question -- but when we think about ETFs, you know, being able to see the underlying securities that I'm invested in versus waiting for maybe 30, 60, 90

days for a mutual fund to report might be a little bit different. So, that transparency is huge; that kind of gives you a comfortable feeling as to what you're investing in and what your allocation is within that particular exchange traded fund.

And then, the other thing too is that the possible tax efficiency, right. And so, there's less trading activity typically in passive, right, when we're thinking about passive and I know we're going to talk about that in a little bit, but they allow for a better portfolio or tax management because of the portfolio managers. They tend to have less taxable gains with most of the exchange traded funds because they're not constantly selling; you're not redeeming specifically like you would be with a mutual fund company. You're buying and selling shares in the secondary market, right.

So, while you may have a tax event because if you buy, you know, an ETF at let's just say 20 dollars, and you sold it for 30 dollars, you're going to have a gain in that particular exchange traded fund for that trade. But inside of the ETF, if there's not a lot of activity or trading going on, or even if the goal is really to make it as tax efficient as possible, they're really going to create and redeem shares and they might even do it in kind internally within the basket of the ETF. So, that's a term called creation redemption. I definitely would recommend, I know we have a great video on it, Jonathan, on Fidelity.com, so

I would encourage all of our viewers to take a look at that. But there is a possible tax efficiency which is a little bit better.

And on top of that, too, when you think about selling, you know, a large block of your mutual fund, let's say, you know, the portfolio manager has to actually sell out of securities and basically to kind of pay out. And that actually has a ripple effect on multiple clients and that's what in turn actually creates those capital gain distributions at the end of the year. And so, sometimes we don't like to see that, particularly if we have a taxable account or, you know, it's not in our best interest from our own personal level, ETFs don't tend to do that. They can pay capital gains, so they can do that, but more often than not, especially with a passive, you don't really see that. You don't see a lot of tax capital gain distributions that are paid out on those. And so, that's one other thing, too.

And I guess the one thing I think most of us know about, is the ability to trade them throughout the day, right. So, they're priced throughout the day. So, we know exactly what those underlying components is, what that exposure is, and we can see exactly what it's trading at and they're meant to be reflective, or as close to as possible, the underlying components minus the cost of the ETF or the expense ratio divided by the amount of shares that is out there.

So, you can actually see the price move in conjunction with the underlying components of the security throughout the day. Which means, you know, I also have the ability to put in a protection order, so I could put in stop losses, trailing stop losses, I could put in limit orders. Whereas like with a mutual fund, and again we'll talk about that, it's not intra-day pricing, right. So, if I put in a buy order, I'm not going to know until the close of business day what I'm getting for a price. But a lot of different things you can do with that. You can also, you know, I know we're not going to focus too much on it, but maybe even selling short, like those types of things.

So, the intra-day pricing, the ability to trade very similar to a stock is very attractive for a lot of investors. So, I think that that's probably one of the things that have intrigued a lot of people into using ETFs as part of their strategy. Because maybe it's even a shorter-term strategy that you want to be invested in. So, those are the big things I think from a strength perspective.

You know, some weaknesses might be, you know, the underlying components. You know, you might see that you have exposure to one country versus another country, or maybe you have exposure to foreign currency and that's a little, you know, it could be a negative, maybe you don't want something to that effect. Also, too, you know, we talked about the ability to trade. Certainly, if you have, you know, a pretty volatile day, you could maybe get stopped out of an order early, maybe that wasn't your intent. So, maybe

the risk strategy that you've had in play, while a stop order if it's triggered, means that it did its job and it's working, it doesn't always make us feel good. Particularly if the security itself, be it a stock or ETF, frankly, goes up in value.

So, there are certainly some disadvantages to that. Also, you know, sometimes ETFs tend to close out. So, we hope to buy into an ETF, you know, we loved the underlying securities and then maybe the ETF doesn't last long, right. And so, what happens in that case is, you know, they simply will pay out the net, you know, whatever the value of the securities are. So, maybe now we have to go back in and find another security to replace it with.

So, certainly quite a bit of strengths and weaknesses I'd say. But overall, for the most part, I think that you can find strength in depending on what type of ETF you're looking for. And certainly, in my opinion, I'd say that there's a place for an ETF in almost any portfolio depending on what your strategy is.

Jonathan Lamothe: So, I'm glad you mentioned the intra-day pricing and trading, that was our number two question so far throughout the live QA. So, I'm glad we got that one right out of the way right off the beginning. The first question that keeps popping up, and we're going to get into it right now, is what is the difference between ETFs and mutual funds? And, you know, if you can run through some of that, and I'm probably sure I'm going to have some questions in between on each of these slides. So, let's have the differences here.

Heather Knight: Absolutely. So, three main ones come to mind, a couple -- actually, there's more than three that come to mind, but the biggest one that I would say is associated costs. Now, I'm going to take a step back here because, Jonathan, I think, you know, you and I have done presentations before the past, take me back five years, six years or so, I would have had a little bit of a different conversation about the expense ratios between a mutual fund and an ETF. So, over the years, the price of mutual funds are certainly starting to come down depending on what you're looking to get exposure to. So, you're starting to see that world.

On top of that, now we have a world where most ETFs are commission-free, right, in a lot of firms. So, when you think about that, it's really kind of becoming a, I called it that race to zero. In fact, Fidelity has zero-expense mutual funds, right. So, there are funds that are low cost, but when we look at the average, and if I'm thinking back to Morningstar's average, their average expense ratio for mutual fund in all of them is still a little bit higher than an exchange traded fund.

And so overall, the expense ratios tend to be a lot less for ETFs than they do for mutual funds, but it's not always the case. And this is why you need to do your due diligence on those mutual funds and the ETFs. In fact, later in the program today I'm going to show you where you can compare them a little bit

side by side from a mutual fund and ETF standpoint. But expense ratios tend to be a little bit less than mutual funds. And again, it's something that you want to revisit at least on an annual basis or maybe sooner with your consultant, or if you're self-directed, on your own.

Jonathan Lamothe: So --

Heather Knight: Oh, go ahead.

Jonathan Lamothe: While we're talking about costs here, can you go through, you know, there's some confusion even now, what is what is load? A lot of people are asking it, I'm asking it. What is load, and what is NAV?

Heather Knight: Yeah, so the net asset value, I'll start with the net asset value -- actually, I'll start with load. So, load is actually that initial upfront cost or the cost for a mutual fund. So, you know, back in the day, I'm thinking like 20 years back working for a full-service firm, everything that we did was based on load; we called them frontends, backends, it might be trailing. So, that's the ultimate cost upfront, if it's a front load, to the investor. So, something that they have to pay right off the bat. And that's actually typically not, you know, it could be one percent, two percent, three percent. So, a loaded fund is actually a charge that's coming out of your pocket.

Now, I tell you that it's kind of hard, especially if you've been with Fidelity for so long, that we actually offer a lot of different funds that have no load, right, or they're waved because of our relationships with other fund companies. And so, you can typically see, there'll be a red sign at the top that says there's a load on this fund and that's something that we can't negotiate. So, that's the fund charging an addition. That's very different than the expense ratio ongoing, too. It could be in addition to an expense ratio which is ongoing. So, load, it could be an upfront cost, or it could be a cost that comes in at the end when you're selling it, or even kind of throughout the timeframe.

So, they carry loads. Mutual funds carry loads; ETFs don't. They have an expense ratio that you can actually see on there and it's best to compare it next to its asset class median because sometimes it could be a little bit more expensive. And then, when you think about that net asset value, both mutual funds and ETFs have that NAV. That's actually going to be what the ETF or the mutual fund is at minus expenses and ratios. So, the net asset value is actually going to tell you what the true value of that is minus those expense ratios.

I would say at this moment in time, and you know, certainly it depends on your own situation, but, you know, if you're paying loads still, you might want to take a look and see, you know, why am I paying a load, does it make sense that I can find a fund that's no load that's similar? And I've got to tell you,

sometimes we're paying fees for things or for services that we may have to pay fees for, right.

So, you know, you've got to take that into consideration to; if there's a fund that's doing real active management and they are dealing, I mentioned before like with the foreign currencies, that may be incorporated as part of that overall fee structure, too. So, something to think about. So, is it worth the price that I'm paying I think. And the best way to take a look at that would be maybe to look at its peers. Which is why, actually, Fidelity.com is set up, to compare against multiple peers, not just, you know, ETFs or mutual funds that are specific to Fidelity.

Jonathan Lamothe: So, we talked about some costs here. Excuse me. Why don't we talk about now some trading attributes and differences?

Heather Knight: Absolutely. So, I mentioned before that they had that intra-day trading, ETFs do, in the secondary market. So, we really like that; that gives us some flexibility. Maybe there's a new story that comes out, anticipation, maybe a little bit more volatility throughout the day. Or maybe, you know, it could be any type of news that's coming out from companies that might be heavily weighted in an ETF or even a sector. So, the ability to go in from when you're trading to be able to set a specific price of what I want to pay for it is a feature of an ETF.

Whereas I mentioned before mutual funds, they do it once a day at the close. So, you can do the stop limit conditional order: if ABC stock does this, then I want to buy more of this ETF. So, you can actually place conditional orders here at Fidelity off of indexes, right. So, off of indexes or I could say, you know, Bank of America's doing this, then I want to go ahead and buy FNCL where, you know, one of the ETFs that include Bank of America, so forth. So, it's kind of neat to be able to do a wide array of conditional orders or even put in your protection orders from an exit strategy standpoint with exchange traded funds. You can't do that with mutual funds.

So, with mutual funds, you can't do limit or stop or conditional orders; you simply have to redeem and you're at basically the will of whatever that price might be at the end of the day. So, think about if severe volatility hits and you had an order open at say 10 a.m. to sell out of your mutual fund and maybe there was some economic news that came out that disturbed that particular, you know, the underlying components, you're taking kind of a blind -- I don't want to say blind, but you're not being able to have that transparency to be able to see exactly what you're going to be selling your mutual fund at. So, you can't place those types of orders with a mutual fund.

And that, for me, might mean that maybe that's a little bit more of a long term vision when you think about mutual funds. So, ETFs, you can short, you can

put them on margin, certainly the requirements are all different. You'll want to take a look at your margin capitulated so see what the requirements might be depending on the exchange traded funds. But that's something that you cannot do with mutual funds.

There's no shorting, and if you're a new buy, so anytime that you buy into a mutual fund and are brand new, it's considered a new issue, so you've got to wait 30 days before it becomes marginable, right. And if you need clarification on that, you can reach out to the trading desk. But it's typically not marginable until after that 30-day mark that hits with the mutual fund if you're buying it for the first time.

Jonathan Lamothe: So, let's go through now, before we get into the demo here, you know, let's go through maybe some of the transparency in taxes. You touched on it earlier, but we've brought up some few differences here if you want to highlight those.

Heather Knight: Absolutely, absolutely. So, when you think about ETFs, and I think this one might even talk a little bit about the, you know, subsectors or what you're actually investing in. You know, again, as the ETFs continue to evolve, there's so many different types of ETFs that are out there that you can go broad or narrow based on an index.

But you can really find niche-type ETFs, right. So, when we think about like sustainability infrastructure, if we're going one step deeper, we're looking for a clean energy type of an ETF for example, we're going to be able to find that a lot easier potentially with an ETF than we might be for a mutual fund.

Sometimes you can find an ETF that has a very small basket of securities, maybe 15 or 20. Years ago, I believe they had a Nashville ETF that was specific to all corporations or companies that were around the Nashville area. So, when you think about that, you're not going to really find a mutual fund that's that small or that niche. So, the broader markets, they tend to be for mutual funds, and then for ETFs, you kind of get broad, small, and very, very small exposures depending on what your own personal, you know, preferences are essentially.

With ETFs, too, you have that transparency, the daily transparency of all holdings, right. And again, I tell you, and cautionary going forward, is that there are different types of ETFs that are coming out that may not be as transparent, right. But for the most part, a lot of the actively managed ETFs, they have to report at the end of the day. So, you have to see exactly what they're holding.

Now, that's a pro and a con because, because of that factor of having to display some of the underlying securities at the end of the day on an ETF, particularly when it's actively managed, you may have a lot of firms not willing

to actually have an ETF that's actively managed because basically if that's the case, then they're sharing their secret sauce with everybody, right. So, it winds up being a position where, you know, it could be a pro, it could be a con, but for the most part, when you look at your underlying holdings on a typical ETF, you're going to see the underlying components and they're going to be as of that day or as of the most recent post.

A lot of times mutual funds, they say that it's typically they're at least a month old; sometimes they're more than a month old. You know, I'm thinking back many, many, many years ago where you'd look at the name of a mutual fund and assume that you're investing in, you know, a specific country or have exposure somewhere, only to find out that the portfolio manager changed the entire underlying holdings to be reflected of something that had nothing to do with the title essentially of the mutual fund. And that could happen without us knowing about it, depending on what's going on with that structure of the mutual fund. So, it's a little bit dated, you can still pull up the holdings, but overall, you're typically going to see the top 10 and it's going to be delayed.

And then ETFs, we talked about that capital gain, and I mentioned before that term creation redemption or in kind creation redemption, meaning, you know, if I'm going to go out to the open market, Jonathan, I'm going to buy some shares of an ETF and I'm buying it directly with the market. I don't have to buy it specifically or sell it with a mutual fund, you know. Somebody else is going

to be trading on the other side of that trade, so I'm actually buying and selling with the open market. Whereas, with a mutual fund, I'm buying and selling directly with that portfolio manager, right. So, they're going to have to, you know, either give me the money that I need if I'm redeeming on a mutual fund and on an ETF, you can see right away what you're getting and you're actually selling with the open market.

So, how do they do that, how do they keep that price close to the underlying components? Well, you know, that's part of that creation redemption process. There is an authorized participant and their job, the goal is to try to keep the underlying security value as close as they can to the last trade so that you're not going to see a very wide premium or discount. And there are exceptions to that rule, just like there always are. There could be situations where certain markets are closed, international so to speak, and that might change the price. But for the most part, you can actually see that, you know, when you look online.

One thing I didn't mention before, Jonathan, and I want to make sure I say this because this could be a pro and a con, too. You know, you have to take a look at the bid/ask spread, right. I mean, that's part of the overall, you know, total cost of ownership, too. And so, when you're looking at an ETF, that could be a pro and a con if you're just throwing out a market order to buy whatever price, there could be a very wide spread between the bid and the ask.

So, thinking about having to pay 20 cents higher than you really should for an ETF based on the underlying components or receiving 20 cents less than, it's important to kind of take a look at that. And that really does talk about the efficiency, too, of the ETF, which we'll share when we do the demonstration. So, that's something to think about. That's certainly a difference between mutual funds and ETFs, too, because again, you know, you put in the total dollar amount and that's really what you're going to get.

Jonathan Lamothe: So, Heather, before we get going here, a lot of questions on dividends coming in. And speaking of transparency, I think it's a perfect time to bring it up. How do dividends work in an ETF? Because there are some ETFs that pay dividends, there are some that don't. Let's try to clarify that as much as we can.

Heather Knight: Yeah, this is actually a question that I still get, right. So, as long as I've been in the industry, we still get the question because it is a little confusing, especially if you're a first timer. So, here's the thing, here's the best rule of thumb that I can give you: if the underlying components of the ETF pay a dividend, typically you're going to receive a dividend. Now, that doesn't mean you're going to get it right away, right. They might have a monthly schedule, and you can see that online, they might have a quarterly schedule,

but they'll typically send it to you based on whatever schedule that they had out there.

So, if the underlying components of an ETF, so you think about like IVV which tracks the S&P 500, right, so that's the iShares version, if the underlying securities pay a dividend, the ETF will also pay a dividend. And typically, you'll see it on a quarterly basis. I would say that there are ETFs to pay on a monthly basis too, right. So, they tend to pay a little bit differently.

So, I guess I could go one step deeper and it kind of say this for some people who are familiar with ETFs but might want a little bit more advanced information: there are some ETFs that if the underlying securities pay a dividend, that it actually sits in cash within the ETF until its distribution date, okay? So, I'm talking about the basket of the components of the stocks in the ETF, right. So, there will always be that cash that pays out, you know, from that perspective.

And then there are some ETFs like IVV that if the underlying securities pay a dividend -- because think about it, you don't want to have like a quarter of a quarter of a percent paid out every single day. Because all these stocks pay out at different times, right. I mean, that would kind of be a pain to receive all that. So, basically with the example of IVV, what they'll do is that they'll reinvest the underlying securities inside of the ETF. You and I aren't going to

see that until it's time to pay us, the shareholders, on that quarterly level and then we'll receive those payouts. So, that's a difference between a term that might be called cash drag versus that little bit additional efficiency.

So, what does that look like from our standpoint? So, you have the choice now if the ETF pays the dividend to you, which it will if the underlying securities inside of the ETF payout, you have the choice with most firms, and definitely with Fidelity, to have those payouts automatically reinvest back into the ETF. Or you have the choice to have that paid out in cash.

That is a broker situation, that's a situation where you set up with us to say yes, you know, Heather, Jonathan I want to take my dividends that are paying out for IVV that are coming to me, I'd like rather than receive them in cash at that quarterly date to go back into the ETF to buy more at. That's that dollar cost averaging maybe component, but that's a choice that you have to make, you know, within Fidelity itself or within your broker itself. Other than that, you know, whatever the standing instructions are is how you'd receive the dividend that gets paid out. Very similar to a stock.

Jonathan Lamothe: Heather, thanks for that. Great explanation there. We're going to get to the fun part here, the actual live demonstration. So, I'm wondering if you can go through maybe some of the tools and resources available on Fidelity.com and show us how we can research ETFs here?

Heather Knight: I'd love to. Let's do that. All right, so right, Jonathan, now we're looking at IVV. I just kind of put the symbol in there. I just pulled it up just kind of to get started because I want to share something with all of our viewers. If you are if you're logged into Fidelity.com as a client, one thing that you want to be aware of is we're always constantly updating, right. We're moving towards the future; we want to make sure that we're trying to update our technology.

That being said, if you actually are using something that looks like this when you're typing in an ETF or clicking on it, you're on a little bit of a version that might be a little older from our research perspective. So, I highly encourage you to look at the top of your screen when you're looking at your ETFs, go ahead and click on that side bar that says use the new research. I mentioned before all the information is the same, I've said three times, I'll add it in there again. But overall, what we're seeing here is a little bit more of a similar version to actually complement the rest of our research on Fidelity.com. We want that similar experience. This is set up and this has been created by our clients, our clients' feedback. So, it's really important that you share that with us; this is how we get things done here at Fidelity. So, everything is based on you guys.

So, let's take a look here. You know, I'll share a couple of things that we went over today. Number one, when you were trying to figure out exactly what that NAV is, or the net expense ratio, we'll start with, it's right here. So, there is that net expense ratio that .03, right. So, that's pretty low in comparison but we'll talk about what that looks like compared to some of its peers. The bid/ask spread over 30 days, slight, slight, very small. This is minute on a bid/asked spread. That's the difference between these two numbers or the bid and the ask. So right now, the bid on this particular ETF is 453.01 and the ask is 453.03. And so right now, there's a two-cent spread between the bid and the ask. That's a very narrow spread. A lot of times you see it's average of about .01 in kind of going forward

And then you have over here the distribution X date, the date it trades without the dividends and the distribution pay date. That's what you were talking about before, that's what we talked about. Like, does it pay the, you know, some sort of a dividend, where do I get my money from investing this? And now you have your tracking error as well and then we'll show you some of the mid points between the bid/ask as well.

Jonathan Lamothe: Heather, if I could interject here -- not to ruin your flow -- what is tracking error? Because, I mean, personally we've seen some people are asking that they've seen it as low as what you're showing here and as high as,

you know, in some cases a percentage or two. So, what exactly is that tracking error?

Heather Knight: Yeah, so the tracking error is -- and by the way, it is a component of the total cost of ownership, right. So ultimately, a tracking error is the annualized standard deviation of a daily return, the differences between the total return performance and the actual total return performance of the underlying index in the ETF itself. So, I guess if I was trying to make it as simplified as possible, I'd say that the tracking error basically looks like the volatility and the difference between the performance of the fund and its index itself. That inherently could become that total possible ownership.

So, there's not only tracking error, there's also something called tracking difference, too. But ultimately, I think I use that benchmark in that even though it's kind of that volatility I'm going to say, how well are you tracking the index that you say that you're doing? You know, what's that volatility going to look like for me? Because it doesn't make more sense that I go out and buy the 500 components of the S&P 500 in this case and then just use that. I mean, chances are pretty much, you know, the answer is no, I'm not going to go out by those underlying components.

But I would say to try to get a good gauge, number one, you're going to compare it against its peers, the tracking error. But number two what you're

going to do is also make sure that it's close as it can be to zero. That tracking error will include or take consideration of that net expense ratio, too. So, you have to take that into account. I see higher tracking errors on sometimes actively managed or with different, you know, unique structures. That's why you have to go back and compare it to either its peers or something similar.

If you see two ETFs that are almost the same or have the same idea or maybe their tracking indexes that are similar, and one tracking error is extraordinarily high and the other one is lower, I'm probably going to air on the side of looking at the ETF that has a lower tracking error. Because overall, that could cost me from a long-term period of time, number one, I might not be tracking the index that I want to which is costing me. And then number two, you have to wonder why something that might be similar, you know, there's a problem with them doing the job that they actually stated.

So, the lower in this case, the better, right, when you look at those tracking errors. In a perfect world if it was replicating exactly the index, you might see a tracking error of point nothing. Like, zero. But you're going to see a nil tracking error; there's no such thing as that, that I'm aware of anyways, I should say. So, that's what that tracking error looks like and it is updated. So, if I saw a very high one, and we'll look at a couple of ETFs today where you can see that, you know, in kind of going forward.

So, this new ETF Research Center. I want to share this with you down here, this is how you navigate. So, you can see you have your charting composition, distribution expenses, ratings and analysis, performance and risk, and comparisons, as well as statistics. I'm not going to touch base on all these; I'd encourage you to look at all of them. Just because we don't have of time to do that today, but I will share with you where I personally go with any ETF.

The first thing I do, is I'm going to the composition. I'm going to the composition because I need to know what the stated objective of this ETF is. Remember I told you before -- and Jonathan, you've seen this, right. We see an ETF, it says it's one thing, then you look at the underlying components and you're like, why did they name it that, right? So, it has nothing to do with the actual objective of the ETF.

So, think back to what it is that you're trying to accomplish for your portfolio. Are you trying to build a core portfolio as part of your overall portfolio, a core position, or you trying to actually add a satellite? That might mean tilting your portfolio to one little area and isolating it. Maybe you want transports as part of your exposure for a shorter-term period of time.

But here, it's going to give you the stated objective, right. And I think all of us know -- or hopefully we do -- that IVV, SPY, and VOO, those are typically the three that we start we start with just because SPY is well known, right. It's

been since day one, the first ETF to come out so we feel comfortable, and it tracks the S&P 500. We're going to pull up a couple different ones today so I can show you what it looks like outside of just the standard ETF for the S&P 500.

This asset is equity, the investment philosophies, passively managed. This is where it's going to tell you if it's active or passive. Active meaning my goal is to actually outperform the index; passive means I'm trying to track it. You're not going to see active trading going on in this particular exchange traded fund.

Style objective: if we're looking at a portfolio to add more exposure to large cap blend, this is where I can actually see what the majority of this ETF has. As I continue to scroll down, I get to see what my exposure is on a geographical level. This is important when you're actually adding in particularly international ETFs. What happens if you think that you are buying into a emerging markets, for example, ETF when you realize your term for emerging markets is very different than a sponsor's? Like how do I know what I'm actually invested in on a country level? You know, what that looks like and so forth. So, this is where you're going to see that.

And then I'm going to see the top 10 holdings and the exposure inside of the ETF or I can view all holdings. All holdings -- remember, not just the top ten -- just by clicking on view all holdings. And then as you scroll down, you can also

see your sector exposure which is nice because you can go back and compare it against your particular portfolio. And then we even drill it down to the industry exposure. So, first place I go is the composition. I want to see where the composition, I want to know what's going on. And remember, it's transparent so I'm seeing, you know, real time information.

Next piece: distributions and expenses. This answers that question that you said, Jonathan, it's something that touched base on. Sometimes ETFs do pay out capital gains distributions. So, how would I even know that? This is a great place to be able to see that. This is showing you all of the dividends that have paid out historically. I can even actually check a box here that says show me the price, the market price, of this ETF historically as it pertains to when those dividends paid out. So, it gives you a list of all of them and for those of you who are looking for going farther back, you can click on view additional distribution history below. Sometimes we don't scroll down the bottom, but it's there.

And let's take a look here now about that distributions recap. You can see the distribution yield. TTM stands for trailing 12 months, over trailing twelve months is 1.25. Total amount of the distribution, the net expense ratio, the gross expense ratio. So, this is giving you all of those distributions. Folks, this is actually just a potential for capital gains, it's the three-year average, it's a Morningstar number. So, it's something to be aware of but that's kind of, you

know, something that you'd see that comes from one of our partners there, research partners.

Ratings and analysis. For those of you who are stock folks that invest in stocks here at Fidelity, what you're going to see here is our analysts are different, right. Here at Fidelity, we try to give you unbiased information. That's why you have access so many different research providers, right. We do that on purpose. Each one of our research providers has a different way of viewing different securities and what their methodologies might be. So that being said, you might favor one over the other, but it's always best to look outside of what your own individual preferences and see what other research providers are saying. So, we give you a lot of that information on the stocks.

When it comes to mutual funds, we'll give you information and rating from Morningstar as well, but with ETFs as you can see, we're going to give you FactSet and Morningstar. So, you're still getting that great information that you need. The neat thing about FactSet is they're also giving you, they're taking all that tracking error and they're taking the tradability, and they're taking those underlying things, you know, that we sometimes don't go as deep into as investors, and they're going to give you a rating. It's going to be from A to F, right. And I would take that information and compare it against its competitors.

And then technical events. Trading central provides us research on technical events with each underlying ETF. So, you've got that technical component, too, thinking about what's my entry or my exit point, do I need to take that into consideration. I'll slide into the comparisons because I mentioned at the very beginning of this, Jonathan, I said hey, listen you've got to take a look at your portfolio as it stands now and your ETFs and go back in and compare and make sure that if you've been holding that same ETF for 5, 10, 15 years, there might be a better one out there or one that's more suitable for your needs today, right. Not always, but you've got to do it; it's part of that review, particularly if you're self-directed, to make sure there's not something that might be more efficient for you.

So, we're going to tell you and here's that ETP term, exchange traded products. We're going to give you the comparison, so we're going to tell you the asset class, investment philosophy, price performance, net assets and expense ratio, and tracking error, right. So, you can see here that SPY has a little bit higher of a tracking error. But you also know this too, the expense ratio is a little bit more. And inherently overall while it's not just this piece, but all things considered, the price performance is slightly different.

Now it may not seem like a lot to you, but if you're talking about an extended period of time, you may be behind the ball when it comes to some of the other ETFs depending on what that total cost of ownership looks like. So, something

to be aware of. Now I can see 20 top similar ETPs here as well, so take that into consideration. So, not always about just the performance, but the underlying components.

And so, how would I compare that or measure that? Like, you know, what are things that I could do to take a look at? Well, the statistics here are pretty neat, too. You can see ownership of the insiders, and down here you'll see my key statistics on my ETF. You'll see the legal structure here saying open end investment company. I'm going to talk about that because I didn't mention this earlier, Jonathan, and I'll pull up an ETF that's going to make sense when we chat a little bit about this. But we're going to give you the portfolio fundamentals and the asset class medians next to that and the percentile.

So, you have a good way of researching your ETFs no. You could see truly where should this be at? Where is this particular ETF on the fundamental level compared to its asset class median, all right? So, that again is underneath the statistics tab. I mentioned that open end investment company, if you click on this, it'll give you a definition but I'm going to share with you another one as well.

Jonathan Lamothe: Heather, we got about 10 minutes left here. I'm wondering if we can go and dive into maybe the screener. We got a lot of folks asking us about how they actually search for something and how they compare the one

ETF to another or an ETF to a mutual fund or how do they find an ETF in a sector they're interested in. So, I'm wondering if you can dive into that.

Heather Knight: Yeah, I can do that. So, if you want to go on your screen and you can go into news and research and ETFs, that's the best place to start off with. And if you actually scroll down here, you can search -- actually, let just show you this really quickly -- you have the ability to search by stock by the way. So, we mentioned before concentration; you could put up the five individual stocks in there and it's going to give you all the matching ETFs, right. So, if I'm looking at three stocks -- Apple, Microsoft, whatever in might be -- if I type of symbols in here, it's going to give me all the ETFs that have exposure to those. I can compare and find similar.

But for screening, if you look here, we give you quick links essentially to some of the screen. So, you can see iShares is one of them, market cap another. And you mentioned sectors, so let's just start with that. So, there's a lot of ways that you can search. If I click on sector, I can actually see a visual of all the sectors that are available out there, I can isolate and look at just the Fidelity sectors, but let's just say that I wanted to take a look at those industrials for example. If I clicked on industrials, it's going to give me a list of all of the ETFs that fall underneath that category immediately, right. So, I know that I'm looking at everything in the theme of sectors and there are 27 of them.

What it did here, Jonathan, is on the left side, it gave me a basically a list of things that I can do to take this 27 and bring it down to two. So maybe while I'm looking at industrials, I'm also interested to know what maybe the market price might look like. Maybe I don't want to pay 1000 dollars for a share for an ETF. I can actually click on view all, which will give me a nice view of all the things that I can actually screen or filter down. So basically, finding that needle in a haystack. So maybe, if I'm somebody that likes to see if there's an ETF that optionable, if I checked that box optionable, it's going to tell me, okay, do you want to look for ETFs that are in industrials that you can do options on? And my answer is yes, I've taken that 27 and I've brought it down 14.

I could do dividends, right. So, I could go back and say I want to know what these dividends have been paid out. So, if I was looking for the dividends, what I'd be focusing more so on is the fundamentals and taking a look at the distribution yield essentially of what it's actually paying. I can do technical if I'm technically inclined. So, you're customizing this based on what you're looking for. If you don't know what the definitions are of any of these screeners, you can click criteria definitions in the upper right-hand corner. What you could do then is save to my screens. So, I'd highly encourage you go back and save to your screens if you're going to build multiple screens to be able to pull up. By the way, you can compare side by side here as well.

So, that's one way you can search for them. And we get a lot of clients, Johnathan, that talk about mutual funds versus ETFs, so I'd like to share that. Do you think we can head into that real quick?

Jonathan Lamothe: I think we've got just enough time to get through that. It's a big question, so definitely want to hit that.

Heather Knight: So, let's go into mutual funds. If you're more prone to using mutual funds as part of it and you're trying to figure out if I want to go mutual funds or ETFs or both, right, you can certainly do both, there's room for both. If I were to look at ETF let's say and I was going to go into that sector equity, you know, same thing maybe what I want to do is just focus solely on those industrials. And we'll take a look at those funds. So, same thing I just did before, on the left side of my screen, that similar view that we had on ETFs shows up. That's our filter; this is where we narrow down our list. I can click on include ETFs and it's going to give me ETFs side by side to the mutual funds. And you'll know that because there'll be a blue box that says ETFs next to it.

So, what's the benefit here? Well, if I wanted to take a look at this ETF versus this particular T. Rowe Price fund, for example, and maybe industrial portfolio, I can check the box next to all three of them, click on compare, and then go side by side to be able to see what the difference is within, you know, income characteristics, pricing, Morningstar rankings, overview, whatever it might be.

Here's what I need to share with everybody: even though you see this show up, it doesn't mean it's the same. Remember, some mutual funds are actively managed, and some ETFs are not actively managed. So, you basically might be investing in some of the same securities, but the actual components of the funds are different. That's why you have to go back to the objective on the ETF and the fund to be able to see if it's passively managed or actively managed, and you can see that on that overview page, right. So, something to think about, you know, as you're taking a look at these and comparing them. So, just because they're side by side, even though they're industrials, they have different approaches, you still need to lift that hood up and look underneath the hood, Jonathan.

Jonathan Lamothe: So, Heather, real quick, what is the difference? What does that actively managed mean versus passive?

Heather Knight: So, actively managed means that the portfolio managers are trying to exceed the benchmark of the underlying. So, basically beat the benchmark I guess, so to speak of what they're actually trying to track. Passive means you're actually tracking the broad base index. So, in the case of SPY, IVV, VOO or those three, those are considered passively managed exchange traded funds. The only time they change is if the index changes. On an actively managed fund, portfolio managers using all different types of tools

that they have in order overweight or underweight specific areas and maybe in order to reach the goal of achieving above and beyond the index. So, they want to actually beat maybe the S&P 500. That's typical to what you'd see on an actively managed fund, an ETF, that's what their goal is, outperform.

Jonathan Lamothe: All right, Heather. Let's see, I'm going to have to flash some disclosures up here, so I took the screenshare away from you. A lot of great information here. I got one from clients that I really want to kind of touch on before we close. Is technical analysis useful for ETFs in the same way that it's useful for stock evaluation?

Heather Knight: Absolutely. You know, that's a way that you could use that as part of your entry, exit point. It doesn't necessarily have to be about an active traded vehicle, but that's something that you could utilize to make a decision on whether or not I want to enter it. You can also use that to maybe track a broader market, too. So, I say the answer is yes; I use both technical and fundamentals for that.

Jonathan Lamothe: So, I know we called it five questions, you must know, I think we went through about 25 here. This was a great webinar. Heather, I want to conclude it now because I feel if we get into another question, we might go way, way over. But Heather, so much thanks for this webinar; it was a really

great and eye opening. I'm glad we took the time to kind of go over some of the basics here.

END OF AUDIO FILE

ETFs are subject to market fluctuation and the risks of their underlying investments. ETFs are subject to management fees and other expenses. Unlike mutual funds, ETF shares are bought and sold at market price, which may be higher or lower than their NAV, and are not individually redeemed from the fund.

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