

Understanding Actively Managed Exchange Traded Funds

With so many investors and their advisors questioning traditional market thinking about index-based investing, exchange traded funds (ETFs) are starting to move beyond their traditional passive index territory into more active management.

To some, it's a fad. To others, it's a serious threat to the territory traditionally held by mutual funds. Yet, one thing so far is clear. Many of the biggest names in the mutual fund world are now seeking permission from the U.S. Securities and Exchange Commission to offer actively managed ETFs. For advice on this new generation of securities, investors should speak with a qualified financial advisor such as a financial planning professional.

ETFs are baskets of securities that trade like stocks and, until recently, have almost always tracked market indexes like the Standard & Poor's 500. ETFs have certain advantages over mutual funds – they generally have offered lower fees and tax advantages than mutual funds, and clearer tracking of their underlying investments because they are required to make that disclosure daily.

Here's what's changing. After the ETF industry won regulatory approval for actively managed funds after a 10-year effort, the first actively managed bond ETF surfaced last spring with a few more based on stocks. What does active management mean? Those managers have more leeway to choose the underlying investments within a fund, while indexed funds require holdings to mirror its chosen index.

What will make things interesting in the new ETF world is the continuing requirement that these active managers disclose every step they make. This is why active management is a challenge; because in the traditional mutual fund world, managers don't have competitors looking over their shoulders when they try to build or exit positions. In the ETF world, disclosure is made on a daily basis, so managers have to worry about competitors mimicking their strategy and foiling their efforts to get the best price for their investments.

Some experts believe that as this category develops, the first baby steps for investing will go toward major stocks that are generally less volatile and, as a result, tougher for competitors to mimic. Others believe that actively managed ETFs will operate with a series of managers whose moves would be tougher to spot on any particular ETF's disclosure list. However, as actively managed ETFs evolve, it makes sense to ask the following questions:

How will these investments fit into my overall portfolio? It makes sense to look at how ETFs fit into one's overall portfolio mix given particular retirement and investment objectives as well as tax considerations.

How about fees? One of the chief advantages of index-based ETFs was low expense ratios. Actively managed funds generally do cost more. Try and get an idea of what the fee structure will be before you invest, and compare them to similar investments in the mutual fund arena.

What are the tax issues? Active ETFs have better tax advantages because the fund manager can sell the lowest-basis stocks via in-kind stock transfers through the creation and redemption process. This helps systematically reduce the tax exposure for investors.

What about the track record? This is a very good point, because as a relatively new investment category, it's important to realize that these new categories of ETFs won't have terribly long investment records to compare to other investments. Do your homework first.

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How to Screen a Prospective Financial Planner

The year's headlines have not been great for the markets, individual investments, or for that matter, the track record of some financial planners.

Yet, according to the 2008 Financial Planning Association® (FPA®) and Ameriprise® *Value of Financial Planning* study, individuals who manage their money according to a financial plan not only feel they have a clear financial direction, but they are statistically most likely to save more than 10 percent of their gross income, giving them the best chances for overall financial security.

But, if you've never met with a financial planner or if it's been years since you visited one, there are some important questions you should ask during screening and selection:

What training do you have? Find out how long the planner has been in practice and what kind of certifications they hold. A CERTIFIED FINANCIAL PLANNER® professional is someone with a minimum experience of three years who has completed a comprehensive course of study at a college or university offering a financial planning curriculum approved by Certified Financial Planner Board of Standards, Inc (CFP Board). CFP® practitioners must pass a comprehensive two-day, 10-hour CFP® Certification Examination that tests their ability to apply financial planning knowledge in an integrated format. Based on regular research of what planners do, the exam covers the financial planning process, tax planning, employee benefits and retirement planning, estate planning, investment management and insurance. You can also check to see if they have had any public disciplinary actions taken against them by going online and checking The CFP Board of Standards Web site: <http://www.cfp.net/learn/disciplineactions.asp>.

What services do you offer? What a financial planner offers is based on credentials, licenses and areas of expertise. Generally, financial planners cannot sell insurance or securities products such as mutual funds or stocks without the proper licenses, or give investment advice unless registered with state or Federal authorities. Some planners offer financial planning advice on a range of topics but do not sell financial products. Others may provide advice only in specific areas such as estate planning or on tax matters. If you're talking to a planner who would actually manage your money, it's likely that they're registered with the U.S. Securities and Exchange Commission because firms managing more than \$25 million dollars must register with the federal agency. For less than \$25 million, money managers have to register with their state securities agency.

How do you charge for your services? Professional planners will provide you with a financial planning agreement that spells out the services they provide and how they'll be compensated. Payment can happen in one of several ways:

- Salaried planners are actually employees of a firm, and you help pay their salaries through fees or commissions you agree to pay.
- Direct fees to the planner through an hourly rate, a flat rate, or on a percentage of your assets and/or income.

- Commissions paid by a third party from the products sold to you based on the planner's recommendations. Commissions are typically a percentage of the amount you invest based on those recommendations.
- A hybrid of fees and commissions based on services. A planner may charge a fee for designing a comprehensive financial plan and occasional visits and calls to review it, while commissions might come from products they sell that you invest in. (Planners may offset some fees in exchange for commissions.)

How do you feel about teaching and training? One of the primary benefits of having a financial planner is education about the moves you are making or may potentially make. Don't view a planning relationship as tossing someone your finances so you won't have to deal with them anymore. As long as you're paying for their services, make sure you get a long-term education out of it.

What will you need me to bring to our first meeting? When you select a planner, they'll give you a list of documents and information to bring in for your first meeting, and generally, it will be called an income and expenditure checklist. You'll need to bring in or detail:

Income

- A current pay slip
- Profit and loss statements for business income
- Pension income statements
- Statements of non-investment income
- Family trust distribution documents
- Tax returns
- Annuity, maintenance agreement statements

Expenses

- Home: Mortgage, rent statements, utilities, household repairs, insurance, appliance purchases, landscaping or house cleaning
- Transportation: Gasoline, car loan, public transit expenses and parking
- Food: Grocery and restaurants
- Medical: Doctor, dentist and prescription bills
- Education: Tuition, school fees
- Child care: In-home or outside-the-home care
- Personal grooming: Clothing, shoes and accessories, hair, makeup
- Pet care: veterinarian, food and grooming bills
- Insurance: Health, life, auto, disability

An asset and liability checklist: This is a summary of what you own and what you currently owe. You'll need to bring or detail:

Assets:

- Principal residence
- Vacation home
- Investment property
- Bank accounts
- Investments

- Collectibles and personal property
- Automobiles, other vehicles

Liabilities:

- Mortgages
- Credit card debt
- Auto loans
- College loans
- Business loans

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