

Exchange Traded Funds Provide Inexpensive Diversification

Diversification is a widely accepted investment principle. It merely means investing in a large number of stocks or bonds. This decreases the risk to your portfolio if one particular stock or bond should decrease in value. There are many methods of achieving the required diversity in stocks or bonds. The investor can select and purchase the individual stocks or bonds one at a time. This can be a very expensive task due to the many brokerage fees involved. It is also very time consuming for the average investor. Investors sometimes turn to mutual funds for diversification. The investor's funds are pooled with that of other investors and this money is managed by a company of professionals to purchase stocks and bonds. The management company charges fees and commissions for managing the portfolio.

Exchange traded funds are similar to mutual funds in that they use the pooled money of many investors to invest in a basket of securities. However, exchange traded funds generally invest in a very specific group or class of securities. Exchange traded funds are attractive as investments because of their low cost. Exchange traded funds have a lower expense ratio than comparable mutual funds. An expense ratio is computed as an annualized percentage of assets rate. ETF's have lower shareholder-related expenses and [debt consolidation](#). Since an exchange traded fund does not have to invest cash contributions or fund cash redemptions, an ETF does not have to maintain a cash reserve for redemptions and thereby saves on brokerage expenses. Mutual funds can charge 1% to 3%, or more; index funds are generally lower, while ETFs are almost always in the 0.1% to 1% range. Over the long term, these savings can compound into a noticeable difference. An Exchange traded fund or ETF is the preferred method of achieving diversification for many investors. They give the investor both ease of investing and low expenses while providing the required portfolio diversity.

About the Author

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