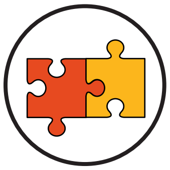
ETFs vs. Mutual Funds: The Same, But (Very) Different



ETFs and mutual funds can accurately be characterized as “sister” investment products because of their many similarities:

- Both are basically baskets of investments and offer a diverse range of investment types and strategies;
- Because a single fund can hold hundreds of individual stocks, bonds or other types of investment instruments, both ETFs and mutual funds can help mitigate investment risk; and
- Both are professionally designed and managed, ensuring investors of a certain level of trustworthiness and credibility.

But the similarities stop there. ETFs and mutual funds sometimes have significant differences in everything from fees and expenses, accessibility and minimum investments, to tax efficiency and trading costs.

Both ETFs and mutual funds can be a viable part of an investor’s strategy. Which is the better choice depends in large part on an investor’s overall goals and approach to investing. To make informed decisions about which product can best meet their needs, investors should understand the key differences between ETFs and mutual funds. We’ve outlined some of the key differences in Exhibit 1, on page 2.

EXHIBIT 1: KEY DIFFERENCES BETWEEN ETFS AND MUTUAL FUNDS

	ETFS	MUTUAL FUNDS
Trading	Intraday (daily and continuous) pricing: ETFs are traded on the major stock exchanges so share price fluctuates the same as any stock; limit orders can be used to control/ execute trades; put and call option trades are available	Forward pricing: Net asset value (NAV) or share price is calculated once each day after market close; limit orders not available; option trades not available
Disclosure	Daily disclosure of portfolio holdings for actively managed ETFs; daily disclosure of a representative sampling of securities that mirror the index being tracked for passive funds; full disclosure of fluctuating NAV during trading hours and number of days traded at premium or discount during previous year	Monthly or quarterly disclosure of portfolio holdings; daily disclosure of NAV
Accessibility	Can be purchased in any brokerage account	Availability depends on distribution agreements with brokers/dealers; in some cases, funds may be purchased directly from fund sponsors
Transaction Costs	Bid-ask spreads affect pricing on each buy/sell order throughout trading day; brokerage commissions may apply	No-load funds purchased directly have no transaction costs; other funds carry front-end or back-end loads (fund commissions), and sometimes broker commissions
Expense Ratios	Generally lower expenses because client services are handled by broker	Generally higher expenses incurred directly by fund sponsor; may include 12b-1 (marketing or distribution) fees
Tax Efficiency	In-kind redemption feature can reduce capital gains tax liability for shareholders	Ability to manage tax liability largely limited due to cash requirements for share creation/ redemption; in certain cases, however, in-kind transfers are possible
Trading on Margin	May be bought and sold on margin	Not allowed; however, after an on-shore fund has been held fully paid for 30 days, the shares held have loan value that can extend margin credit for subsequent stock purchases
Automatic Investing	Not available – ETFs trade as if they are single stocks	Generally available; when handled through broker/ dealer, transactions MAY carry trade commissions
Minimum Investment	Single shares in an ETF can be bought; price will fluctuate throughout the trading day based on market demand	Minimums vary, usually $1,000 to $2,500 but sometimes higher; mutual fund purchases for IRA accounts usually have lower minimums

INVESTOR DEMAND

According to the 2017 Investment Company Fact Book, at just over $16 trillion, assets in U.S. mutual funds dwarf those in ETFs, which were estimated at $2.5 trillion at the end of 2017. But investments in ETFs continue to grow at an accelerated pace while mutual funds continue to see outflows.

Increased awareness among retail investors and their advisers has played a definite role in ETF growth. In turn, ETF sponsors are offering a variety of funds, including ETFs that invest in particular market sectors, industries or commodities, as well as actively managed ETFs. Simultaneously, the mutual fund industry continues to see growth in the popularity of index mutual funds, particularly those indexed to the S&P 500 or other traditional domestic and international stock indexes.

What do ETF and mutual fund investors look like demographically? As the table below shows, households that own ETFs have considerably higher income and financial assets than those that own mutual funds. They are also more highly educated with 67% having a four-year college degree or higher.

EXHIBIT 2: CHARACTERISTICS OF HOUSEHOLDS OWNING ETFS VS. THOSE OWNING MUTUAL FUNDS

	ALL U.S. HOUSEHOLDS	HOUSEHOLDS OWNING ETFS	HOUSEHOLDS OWNING MUTUAL FUNDS
MEDIAN			
Age of head of household[1]	51	51	51
Household income[2]	$55,000	$120,000	$94,300
Household financial assets[3]	$85,000	$375,000	$200,000
PERCENTAGE OF HOUSEHOLDS			
Household primary or co-decisionmaker for saving and investing			
Married or living with a partner	58%	74%	73%
Widowed	9%	5%	6%
Four-year college degree or more	33%	67%	50%
Employed (full- or part-time)	62%	78%	76%
Retired from lifetime occupation	28%	22%	24%
Household owns			
IRA(s)	34%	77%	63%
Defined contribution retirement plan account(s)	47%	78%	85%

1 Age is based on the sole or co-decision maker for household saving and investing.

2 Total reported is household income before taxes in 2017.

3 Household financial assets include assets in employer-sponsored retirement plans but exclude the household's primary residence.

Source: Investment Company Institute, 2017 Investment Company Fact Book

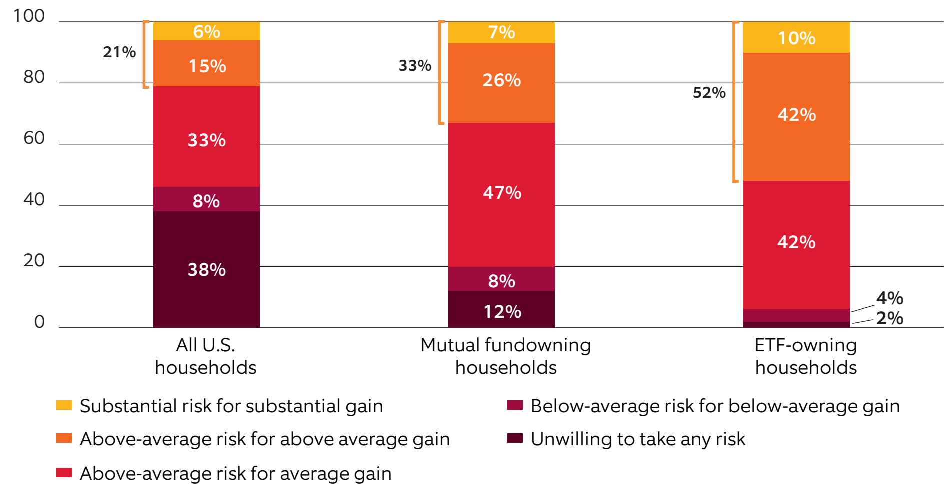
Which Product is Right for You?

Selecting an investment depends on your unique goals, investment horizon and personal preference. A financial advisor can help you weigh the pros and cons of each option for your particular situation. Remember that both ETFs and mutual funds can help meet most investment objectives. Consider adding both to any portfolio to maximize exposure to different asset classes and investing strategies.

It is interesting to note that ETF-owning households say they are more willing to accept greater investment risk for the possibility of higher return. Over half say they would take "substantial" or "above-average" risk for commensurate gains, as opposed to 33% of mutual funds owners and only 21% of all U.S. households.

ETF-OWNING HOUSEHOLDS ARE WILLING TO TAKE MORE INVESTMENT RISK

Percentage of all U.S. households, mutual fund-owning households, and



Source: Investment Company Institute, 2017 Investment Company Fact Book

FIND OUT MORE

The FlexShares approach to index-based investing is, first and foremost, investor-centric and goal oriented. We pride ourselves on our commitment to developing products that are designed to meet real-world objectives for both institutional and individual investors. If you would like to discuss the attributes of any of the ETFs discussed in this report in greater depth or find out more about the index methodology behind them please don't hesitate to call us at 1-855-FlexETF (1-855-353-9383) or visit **www. FlexShares.com**.

IMPORTANT INFORMATION

Before investing, carefully consider the FlexShares investment objectives, risks, charges and expenses. This and other information is in the prospectus and a summary prospectus, copies of which may be obtained by visiting www.flexshares.com. Read the prospectus carefully before you invest.

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An investment in FlexShares is subject to numerous risks, including possible loss of principal. Fund returns may not match the return of the respective indexes. The Funds are subject to the following principal risks: asset class; commodity; concentration; counterparty; currency; derivatives; dividend; emerging markets; equity securities; fluctuation of yield; foreign securities; geographic; income; industry concentration; inflation-protected securities; infrastructure-related companies; interest rate / maturity risk; issuer; large cap; management; market; market trading; mid cap stock; MLP; momentum; natural resources; new funds; non-diversification; passive investment; privatization; small cap stock; tracking error; value investing; and volatility risk. A full description of risks is in the prospectus.

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