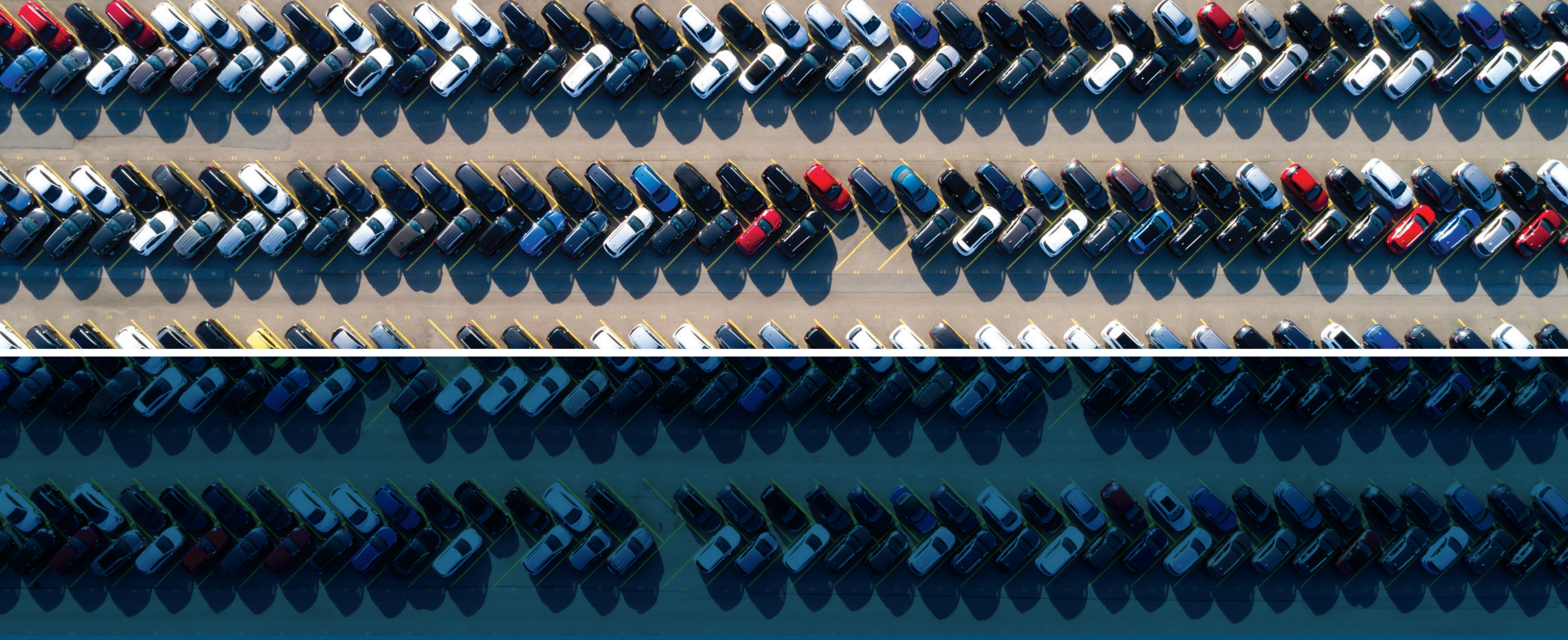


Strengthen your investment foundation

A GUIDE TO EXCHANGE TRADED FUNDS (ETFs)

index IQ
A NEW YORK LIFE INVESTMENTS COMPANY

Not FDIC/NCUA Insured	Not a Deposit	May Lose Value
No Bank Guarantee	Not Insured by Any Government Agency	

What is an ETF?

When it comes to investing, you have a wide array of options to choose from to help you meet your financial objectives—stocks, bonds, and mutual funds being some of the most familiar. Exchange Traded Funds (ETFs) have become an increasingly popular option, and are advantageous in helping an investor build a diversified, more efficient portfolio.

ETFs are funds that attempt to replicate the performance of a particular index instead of outperforming it, like a mutual fund. Meaning, ETFs don't try to "beat" the market, they try to "be" the market.

When you buy a share of an ETF, it represents a portion of all of the fund's underlying investments. This enables you to diversify across a predetermined basket of stocks or bonds through one single fund—providing access to the stock or bond market without having to make individual purchases.

Most ETFs function like an index fund. For example, if you were to purchase an S&P 500 Index ETF, that ETF would own all 500 stocks listed in the S&P 500 Index.[1] It will not trade in and out of those stocks. It will simply own the stocks listed in that index. By buying a share of the ETF, your money is instantly diversified across all of the underlying securities.

All ETFs are subject to market risk, including possible loss of principal. ETF shareholders are subject to risks similar to other pooled investments, such as mutual funds. In addition to general market risks associated with investing in stocks and bonds, there are risks specific to each ETF, which are described in its prospectus.

ETF growth provides greater exposure to the financial markets

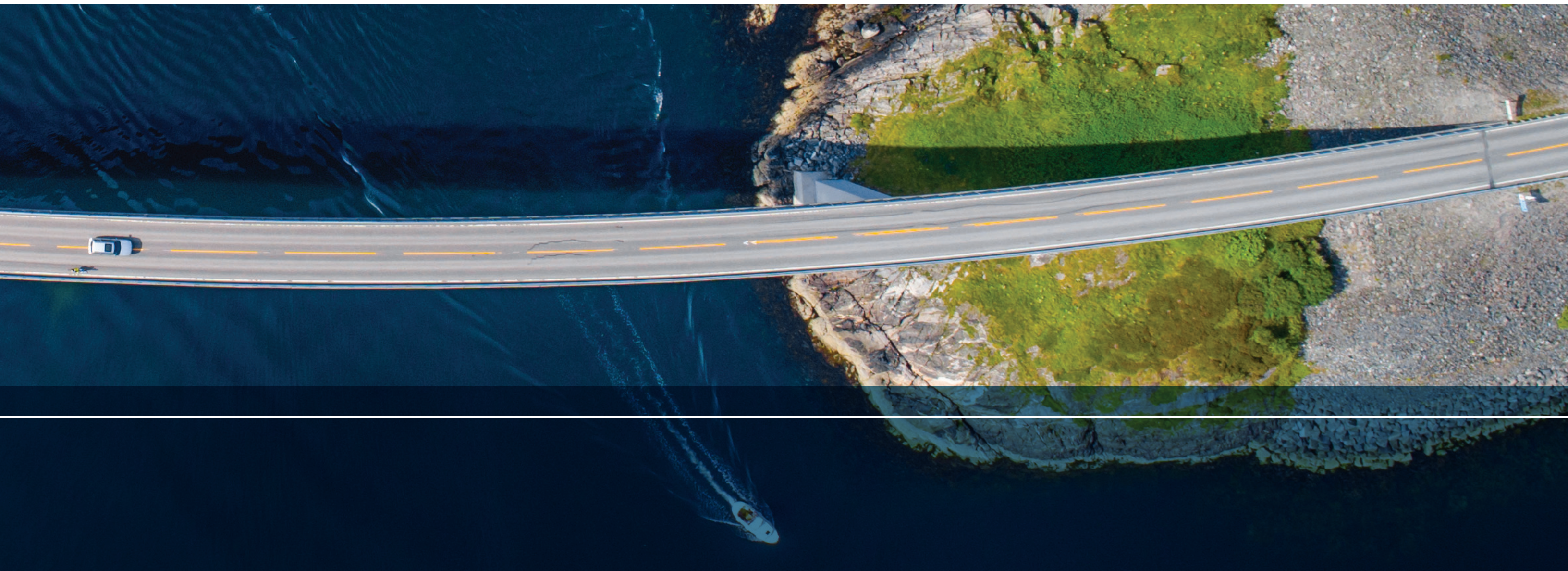
The ETF market has dramatically expanded since the first one was introduced in 1993.[2] In fact, within the last 10+ years alone, growth in the number of ETFs currently available—and the respective assets under management—has exceeded 800%!

The rapid growth of this market is a testament to the increased demand from investors for these types of investment vehicles.

Types of ETFs

The ETF market includes both broad markets and specific sectors and countries. The majority of funds within the ETF market can be categorized into the following types:

Type of ETF	Description
Equity ETF	Tracks a particular equity index.
Bond ETF	Provides exposure to a universe of bonds being tracked by the market (i.e., high-yield bonds, municipal bonds, and Treasurys).
Sector and Industry ETF	Provides exposure to a specific industry.
Commodity ETF	Tracks the price of a certain commodity.
Style-Specific ETF	Tracks a market capitalization focus or investment style.
Foreign Market ETF	Tracks markets outside of the U.S.
Inverse ETF	Designed to profit from a decline in the value of an underlying benchmark by holding various short positions, or using a combination of advanced investment strategies to profit from falling prices.
Alternative Investment ETF	Implements a nontraditional asset class or investment approach that can help manage volatility during times of uncertainty for traditional asset classes.



Increased diversification through broader access[3]

ETFs can be used to provide low cost,[4] transparent exposure to various asset classes, regions, sectors, or investment styles. Combining ETFs and mutual funds within a portfolio can provide the flexibility needed to gain complete and total access to the financial markets.

While ETFs and mutual funds are similar in many ways, there are also a number of differences. ETF investors can see exactly what they own on a daily basis, helping them minimize overlap between sectors and individual securities that they own, creating greater overall portfolio diversification.

Similarities and differences between ETFs and mutual funds

	ETFs	Mutual Funds
Priced, bought, and sold throughout the day[5]	✓	
Offer investment diversification	✓	✓
Minimum investment requirements		✓
Managed by investment professionals	✓	✓
Active and passively managed options	✓	✓
Occasional fees or commissions required with a trade	✓	✓
Ability to make or lose money	✓	✓
Sell individual shares directly to, or redeem from, retail investors		✓
Options available on the ETF or mutual fund	✓	
Daily transparency of holdings	✓	

Like mutual funds, ETFs charge a management fee that is deducted directly from the assets of the fund. With ETFs, a broker's commission fee is also assessed each time an investor buys and sells shares.

Intraday trading supports liquidity and agility

Traded throughout the day like traditional stocks and bonds, ETFs provide a high level of liquidity and increased flexibility to take advantage of market movements. For individual stocks and bonds, liquidity is all about trading volume and its regularity. For ETFs, there's more to consider.

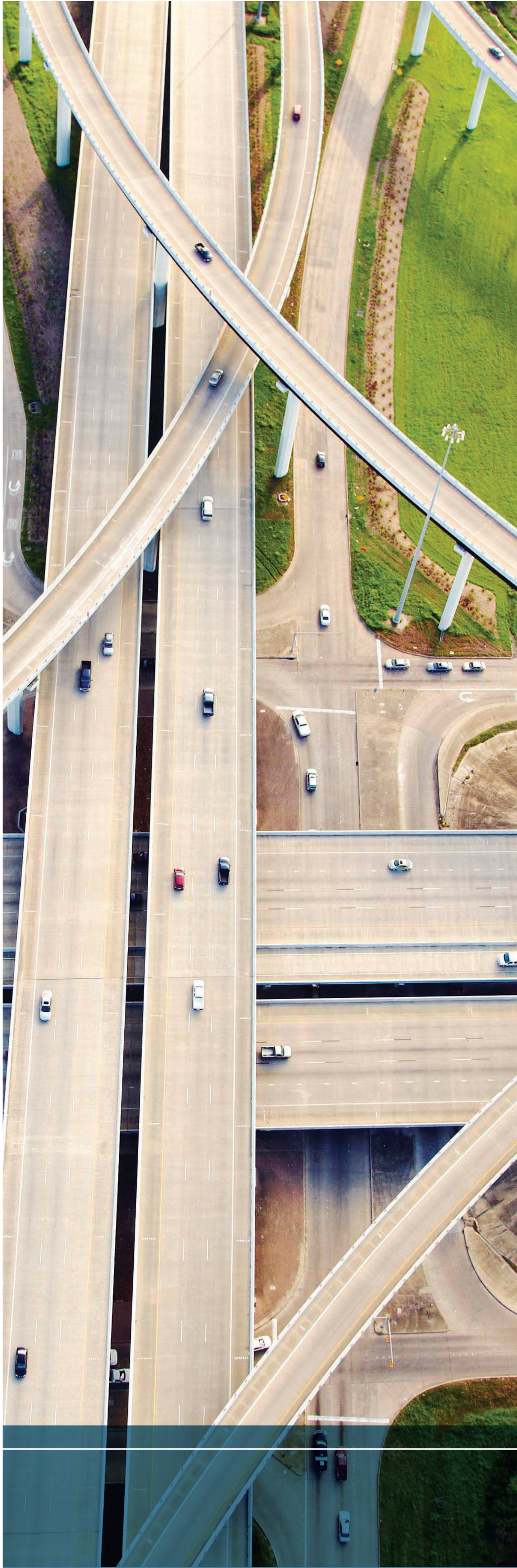
An ETF is not a stock or bond

ETFs are often recognized for their liquidity and exchange trading capabilities. While exchange trading enhances the flexibility of trading throughout the day, not all ETFs are the same. Some may trade rarely or only at wide spreads. Additionally, some ETFs may hold illiquid securities. It is always prudent to read the prospectus to gain a better understanding of the types of ETFs you are investing in and the processes they seek to follow.

Even though there are similarities to how stocks and bonds are traded, the key difference with ETFs is that they trade on two separate and distinct markets—a primary and a secondary—whereas stocks and bonds only have access to a secondary market.

The primary vs. secondary market

The driving factors behind market liquidity in both the primary and secondary markets are very different. In the secondary market, investors buy and sell ETF shares throughout the day, determining liquidity through the value of those ETF shares traded. In the primary market, investors—such as large institutions and educational endowments—work with "authorized participants" to create shares or redeem shares in order to offset changes in demand and help maintain a flexible supply. It is this creation/redemption process that helps drive liquidity, determined by the value of the underlying shares making up the respective ETF.



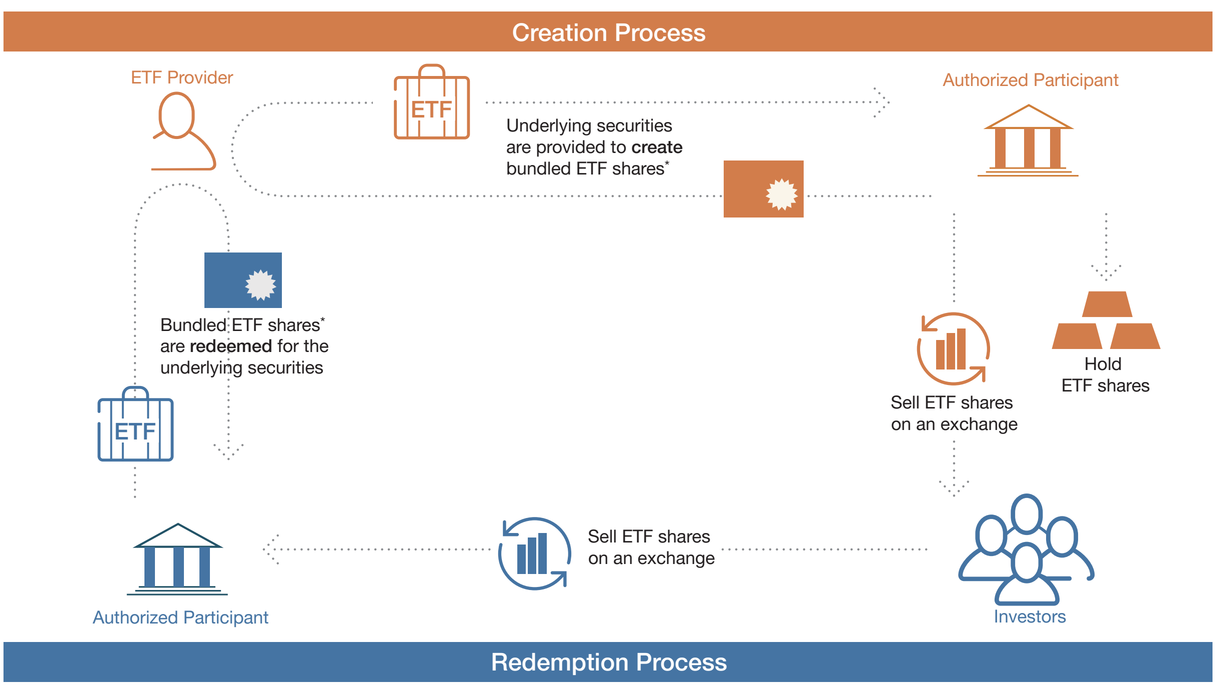
What is an authorized participant and why are they so important to the process?

An authorized participant is someone with significant buying power, since it is the authorized participant's job to acquire all of the securities an ETF wants to hold. For instance, if an ETF is designed to track the S&P 500 Index, the authorized participant needs to buy shares in all the S&P 500 companies in the exact same weights as the Index, then deliver those individual shares to the ETF provider.

In exchange, the ETF provider gives the authorized participant a block of equally-valued bundled ETF shares, called a "creation unit." Creation units are usually formed in blocks of 50,000 ETF shares. In this instance, both parties benefit from the transaction. The ETF provider gets the stocks it needs to bundle into ETF shares and track the Index, and the authorized participant gets an equivalent value of ETF shares to trade on the open market.

The process can also work in reverse. An authorized participant can remove ETF shares from the market by purchasing enough of those ETF shares to form a creation unit, and then deliver that creation unit to the ETF issuer in exchange for the same value in the underlying securities of the respective ETF.

Creating and redeeming shares helps maintain a flexible supply and ETF price consistency



*Bundled ETF shares (50,000 shares) = 1 creation unit

Your investments work harder for you instead of someone else

Lower expenses

Operating expenses are incurred by all managed funds, regardless of the structure. However, ETF operating expenses are more streamlined compared to others. These lower costs are the result of:

- **Reduced fund administration costs.** When a cost can be passed on to another entity, such as the brokerage firm holding a customer's ETFs in one of their accounts, a client service-related expense such as this helps keep costs down at the fund level.
- **Reduced administrative, service, and record keeping costs.** Since it is the brokerage firm's responsibility to issue monthly statements, annual tax reports, quarterly reports, and 1099s to its clients, ETF companies benefit from the lower overhead—and part of that savings is passed on to individual investors in the form of lower fund expenses.
- **Absence of redemption fees.** Shareholders in ETFs avoid the short-term redemption fees that are charged on some other managed funds.[3]

Tax consequences

ETFs are structured for tax efficiency. With regard to capital gains taxes, they tend to be lower than other managed funds since trading/turnover within the ETF itself is relatively low. Additionally, investors only realize any potential capital gains when they sell the ETF itself.

Where dividends are concerned, the tax situation differs depending on whether the dividend being issued by the ETF is considered qualified or unqualified. For a dividend to be considered qualified, the ETF needs to be held by an investor for at least 60 days prior to the dividend payout date. The tax rate for qualified dividends then varies between 5%–15%, depending on the investor's income tax rate. For unqualified dividends, investors are simply taxed at their current income tax rate.

About Risk

This material is general in nature and provided solely for educational and informational purposes. It is not meant to provide tax advice. To obtain tax advice on ETFs, consult with your own tax advisor.

All ETFs are subject to market risk, including possible loss of principal. ETF shareholders are subject to risks similar to other pooled investments, such as mutual funds. In addition to general market risks associated with investing in stocks and bonds, there are risks specific to each ETF, which are described in its prospectus. For example, the value of securities held by the ETF may decline. ETFs that hold international investments may involve risk of capital loss from unfavorable fluctuations in currency exchange rates, differences in generally accepted accounting principles, or economic or political instability in other nations. ETFs that invest in the bond market could be hurt by rising interest rates (bond prices and interest rates move in opposite directions).

Alternative investments are speculative, not suitable for all clients, and intended for experienced and sophisticated investors who are willing to bear the high economic risks of the investment. Fixed-income investments are also subject to credit risk, the risk that the issuer of a bond will fail to pay interest and principal in a timely manner, or that negative perceptions of the issuers ability to make such payments will cause the price of that bond to decline.

1. The S&P 500 Index is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large-cap universe.
2. Source: etfgi.com, a wholly independent research and consultancy firm, as of 12/31/20.
3. Diversification does not ensure a profit or protect against a loss in a declining market.
4. Like mutual funds, ETFs charge a management fee that is deducted directly from the assets of the fund. Therefore, the investment return of an ETF may be lower than the underlying benchmark index. This fee may be referred to in the prospectus as an “expense ratio,” “management fee,” or “investor fee.” A broker’s commission fee is also assessed each time an investor purchases shares in an ETF. It’s important to note that while ETFs do not have some of the administrative costs as similar index mutual funds, they do not always have lower fees.
5. ETF sales are settled three days after a transaction, delaying the opportunity to reinvest funds.

For more information

800-624-6782
newyorklifeinvestments.com

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