

ETF mechanics

An **Exchange Traded Fund (ETF)** is a type of investment vehicle that in many ways is a hybrid of a mutual fund and a stock. Like a mutual fund, an ETF can be built to track the performance of an index or can be actively managed. Similar to a stock, an ETF can be bought or sold on an exchange.

The first ETF was launched in the US in 1993. There are more than 8,600 different ETFs available worldwide¹. ETFs have grown to a universe worth more than \$10 trillion globally as of 2021.²



How does an ETF work?

Why are ETFs used?

Key Benefits

Tactical allocation – Quick and easy to transact, ETFs can be bought and sold the same as a single stock.

Cost – ETFs are considered more cost effective than mutual funds as they have typically lower expenses. However, since buying or selling ETF shares on an exchange may require the payment of brokerage commissions, trading activity may increase the cost of ETFs.

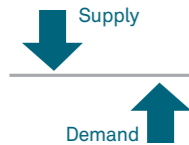
US tax efficiency³

- Through the creation/redemption mechanism, ETFs can transfer securities in-kind to meet redemption needs.
- This type of payment, made in securities as opposed to cash, is referred to as an in-kind payment.

- Meanwhile, in order to settle a redemption, a redemption a mutual fund will sometimes need to sell holdings, potentially realizing capital gains that are passed back to shareholders.
- The ability to buy and sell an ETF in the secondary market allows investors to meet on an exchange without always having to redeem at the fund level.

Supply & demand

Step 1: When new ETF shares need to be created (demand outweighs supply), market makers go through an authorized participant (AP) to perform the transaction.

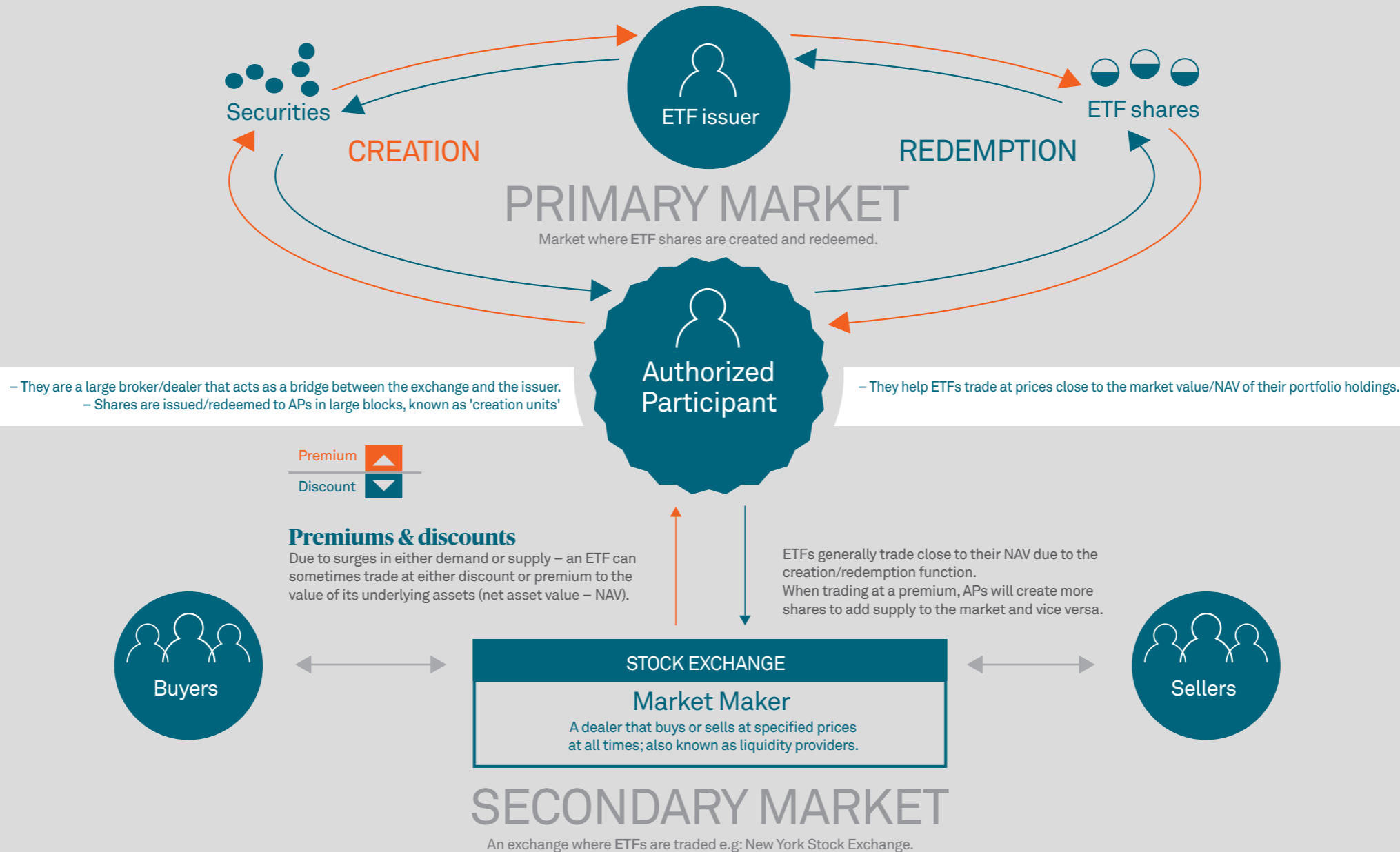


Step 2: The AP will compile the necessary securities/cash for delivery to the ETF.

Step 3: Upon receipt of the securities and cash, the ETF issuer will issue new shares of the ETF to the AP.

Step 4: The AP will pass the ETF shares to the market maker to replenish inventory.

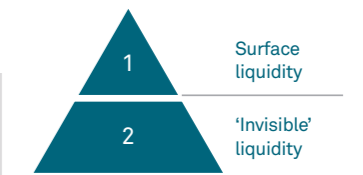
The process works in reverse for redemptions when supply exceeds demand.



Liquidity

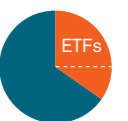
ETF liquidity = exchange volume + volume of underlying basket

- 1. Secondary market volume:** The number of existing shares in the ETF available to be traded.
- 2. Primary market volume:** The volume of the underlying basket of stocks in the ETF.



Did you know?

In January 2022, trading in ETFs accounted for almost half of all US equity trading volumes, up from around 30% in 2021.⁴



1. Source: Statista. Worldwide ETF Assets under management 2003-2021. Published March 18, 2022.

2. IBID.

3. ETF tax efficiency can be derived from certain structural elements, including: turnover, which in passive strategies is typically lower than in active; in-kind redemptions, in which no capital gains are realized. This can allow investors more control over the timing of their tax liabilities based on when they generally sell their position. Please consult your own tax advisor or financial professional for more detailed information on tax issues as they relate to your specific situation.

4. Source: ETF Stream. ETF volumes hit record levels amid market turmoil. January 31, 2022.

ETFs trade like stocks, are subject to investment risk, including possible loss of principal. The risks of investing in the ETF typically reflect the risks associated with the types of instruments in which the ETF invests. Diversification cannot assure a profit or protect against loss. Past performance is no guarantee of future results. ETF shares are listed on an exchange, and shares are generally purchased and sold in the secondary market at market price. At times, the market price may be at a premium or discount to the ETF's per share NAV. In addition, ETFs are subject to the risk that an active trading market for an ETF's shares may not develop or be maintained. Buying or selling ETF shares on an exchange may require the payment of brokerage commissions. This material has been provided for informational purposes only and should not be construed as investment advice or a recommendation of any particular investment product, strategy, investment manager or account arrangement, and should not serve as a primary basis for investment decisions. Prospective investors should consult a legal, tax or financial professional in order to determine whether any investment product, strategy or service is appropriate for their particular circumstances. Views expressed are those of the author stated and do not reflect views of other managers or the firm overall. Views are current as of the date of this publication and subject to change. The information is based on current market conditions, which will fluctuate

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