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Insights

THE NUTS AND BOLTS OF EXCHANGE TRADED FUNDS An Investment Vehicle to Add to Your Toolbox





For many financial advisors and investors alike, Exchange Traded Funds, or commonly called ETFs, are a fairly new addition to the investment world vernacular. ETFs, like traditional mutual funds, are portfolios of stocks or bonds, but with a twist: they are traded throughout the day and offer a low cost way to diversify.

While many considered the early ETFs a novelty due to their limited scope, Barclays Global Investors changed that perception by launching a large universe of ETFs

called **iShares** in May of 2000. This innovative launch provided investors with a new and competitive way to access nearly every segment of the domestic and international markets. The asset growth of ETFs since that introduction has been tremendous.

Bell Capital Management has been a strong advocate of utilizing ETFs in portfolio allocations since July of 2000. While actively managed mutual funds are still considered from time to time, the numerous benefits of ETFs are quite compelling. Let's take a closer look.

Core Benefits of Utilizing ETFs:



-  **Diversification** – There are over 200 ETFs available to investors. Through a single transaction, an ETF is designed to closely replicate the performance of a diversified stock or bond index (*i.e.* broad market, large-cap, mid-cap, small-cap, growth, value, industry sector, international and fixed income). Since May of 2000, ETFs have provided investors with an alternative way to effectively implement a variety of asset allocation strategies ***no more style drift!***
-  **Low Expenses & Benchmark Performance** – The internal expenses for ETFs are extremely low relative to traditional mutual funds (*see table below*). While actively managed mutual funds with higher expenses offer the “possibility” to exceed their benchmark return, this has been a most difficult task to accomplish on a consistent basis. ETFs insure the “precise” performance of the market segments they track ***no more lagging the target!***

Morningstar Stock Mutual Fund Category	Average Mutual Fund Expense Ratio	Equivalent ETF Index	ETF Expense Ratio	ETF Cost Advantage
Large-Cap	1.39% *	S&P 500	0.15% *	1.24%
Mid-Cap	1.50% *	S&P 400	0.23% *	1.27%
Small-Cap	1.57% *	S&P 600	0.23% *	1.34%
Foreign Large-Cap	1.60% *	MSCI EAFE	0.38% *	1.22%

* Represents the average of Growth, Blend and Value as of 4/21/06

Source: Morningstar, Barclays Global Investors

Note: ETFs trade like stocks and brokerage transaction costs will apply. These nominal costs have not been factored into the above analysis.

-  **Trading Flexibility** – Investors that trade traditional mutual funds have no other choice than to receive the closing price at the end of each trading day. In contrast, the price of an ETF virtually matches the market value of the underlying securities in a specific index and is updated on a national exchange every fifteen seconds. This continuous pricing allows investors the ability to effectively trade throughout the course of the day ***no more trading limitations!***
-  **Tax Efficiency** – Because ETFs represent a particular stock or bond index, they tend to have minimal on-going turnover. This low turnover, especially relative to most actively managed mutual funds, practically eliminates the likelihood of any significant capital gain distributions ***no more year-end surprises!*** And when truly large transactions do take place by institutional investors, the transactions are made in securities, not cash, resulting in no tax liability to shareholders.

For more information, please contact us at (800) 871-2663 or e-mail insights@bellcapital.com.

There are risks involved with investing, including possible loss of principal.