

Exchange Traded Funds

A Brief Introduction

What You Need to Know about ETFs

- **ETF Basics**
- **Benefits of ETFs**
- **ETFs vs. Mutual Funds**
- **The Role of ETFs in Your Portfolio**
- **Our Next Steps**
- **Appendix: FAQs**

ETF Basics

ETF [eee • tee • eff] n., exchange traded fund

▶ WHAT ARE ETFs?

HOW DO ETFs WORK?

ARE ETFs NEW?

What Are ETFs?

- A collection (or “basket”) of securities that typically tracks a specific market index
 - Are similar to index mutual funds
 - Possess trading flexibility of individual stocks and are listed on major exchanges

ETF Basics

WHAT ARE ETFS?

▶ **HOW DO ETFS WORK?**

ARE ETFS NEW?

How Do ETFs Work?

- Individual investors purchase and sell ETF shares through a brokerage, just like individual securities
- ETF sellers and buyers are matched via the exchange
- ETF shareholder trades have no tax impact on other shareholders

ETF Basics

WHAT ARE ETFs?

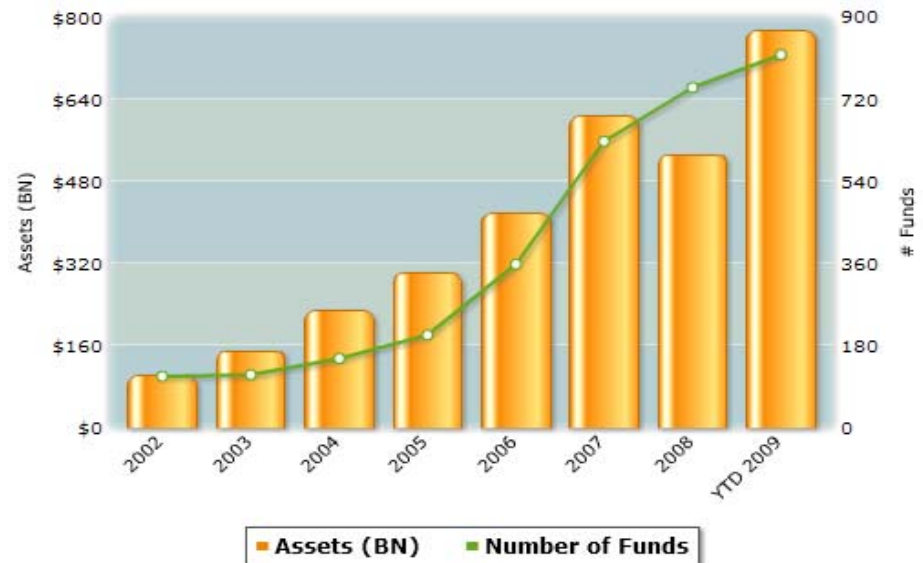
HOW DO ETFs WORK?

▶ ARE ETFs NEW?

Are ETFs New?

First ETF launched 15 years ago

ETF Growth over Last 5 Years



Source: SSgA Strategy & Research, December 2009

Benefits of ETFs

ETFs offer a compelling mix of benefits

Precision investment control

▶ EASY DIVERSIFICATION

TRANSPARENCY

TRADING FLEXIBILITY

ADVANCED TRADING TECHNIQUES

Precision cost control

LOW COSTS

TAX EFFICIENCY

Easy Diversification

You have precise control over your investment strategy

- **Indexing benefits:** As index investments, ETFs offer diversified and/or target diversified exposure to virtually any segment of the market, both in the US and internationally
- **Broad market exposure:** ETFs track broad indexes that cover nearly all market capitalizations and investment styles
- **Precise exposure:** ETFs track the performance of specific sectors, industries and even commodities

Diversification does not ensure a profit or guarantee against loss.

Benefits of ETFs

Precision investment control

EASY DIVERSIFICATION

▶ TRANSPARENCY

TRADING FLEXIBILITY

ADVANCED TRADING TECHNIQUES

Precision cost control

LOW COSTS

TAX EFFICIENCY

Transparency

You have all the information you need to make informed investments — no strategy drift or black boxes to decipher

- Generally with ETFs, you know which securities the ETF holds— there is no need to wait for the end of the quarter to review the fund's holdings

Benefits of ETFs

Precision investment control

EASY DIVERSIFICATION

TRANSPARENCY

▶ TRADING FLEXIBILITY

ADVANCED TRADING TECHNIQUES

Precision cost control

LOW COSTS

TAX EFFICIENCY

Trading Flexibility

You have precise control over your investment strategy

- Buy and sell ETF shares through a brokerage account, just as you would stocks
- Buy and sell ETF shares at their current market price anytime during the trading day

Frequent trading of ETF could significantly increase commissions and other costs such that they may offset any savings from low fees or costs.

Benefits of ETFs

Precision investment control

EASY DIVERSIFICATION

TRANSPARENCY

TRADING FLEXIBILITY

▶ ADVANCED TRADING TECHNIQUES

Precision cost control

LOW COSTS

TAX EFFICIENCY

Advanced Trading Techniques

There are more options for implementing investment strategies and taking advantage of market movements

- Because ETFs trade like stocks, investors can employ a wide range of trading techniques, including Limit Orders, Stop Loss Orders, and Short Selling

The use of short selling entails a high degree of risk, may increase potential losses and is not suitable for all investors.

Frequent trading of ETF could significantly increase commissions and other costs such that they may offset any savings from low fees or costs.

Benefits of ETFs

Precision investment control

EASY DIVERSIFICATION
TRANSPARENCY
TRADING FLEXIBILITY
ADVANCED TRADING TECHNIQUES

Precision cost control

▶ LOW COSTS
TAX EFFICIENCY

Low Costs

You keep more of your returns when costs are low

- By virtue of being index investments, ETF costs are generally low
- Due to low turnover of most ETFs and the indexes they track, transaction costs are minimized
- Investors should not frequently trade their ETF shares, since high brokerage commissions could erode their investment

Benefits of ETFs

Precise investment control

EASY DIVERSIFICATION
TRANSPARENCY
TRADING FLEXIBILITY
ADVANCED TRADING TECHNIQUES

Precise cost control

LOW COSTS
▶ TAX EFFICIENCY

Tax Efficiency

You control when you incur most taxes

- Because ETFs track market indexes, turnover is generally low
- Typically, lower turnover results in fewer capital gains and thus lower taxes
- Investors typically don't realize capital gains from other shareholder redemptions

Passive management and the creation/redemption process can help minimize capital gains distributions.

ETFs vs. Mutual Funds

ETFs and index mutual funds are similar in that each holds a collection of securities intended to represent a specific investment theme or objective (e.g., growth or value stocks, homebuilding industry, small cap stocks, etc.). They are not the same, however.

► PRICING

TAX CONSEQUENCES

COSTS

MINIMUM INVESTMENT

Pricing

ETFs

- ETF shares are bought and sold during trading hours at their market value, just like stocks
- ETF pricing captures the precise movement of the market at the time of purchase or sale

MUTUAL FUNDS

- Buy and sell orders for shares are placed and transacted after market close at the mutual fund's closing market value
- The closing value of mutual fund shares is calculated at the end of the trading day

ETFs vs. Mutual Funds

PRICING

▶ TAX CONSEQUENCES

COSTS

MINIMUM INVESTMENT

Tax Consequences

ETFs

- ETF Investors decide when to sell their ETF shares and any associated capital gains tax is theirs alone to pay
- Like mutual funds, occasionally an ETF may have to pay taxes on capital gains triggered by changes but this is typically less than a mutual fund

MUTUAL FUNDS

- If multiple shareholders redeem their shares concurrently, the fund manager may have to sell underlying holdings to raise cash to pay those shareholders; in addition to transaction costs, this could trigger capital gains.
- In the above scenario, taxes on those capital gains would then be absorbed by all shareholders in the fund

Information represented in this piece does not constitute legal or tax advice. Investors should consult their legal, tax, and financial advisors before making any financial decisions.

ETFs vs. Mutual Funds

PRICING

TAX CONSEQUENCES

▶ **COSTS**

MINIMUM INVESTMENT

Costs

ETFs

- ETFs historically have had a lower average expense ratio — 0.56%*

MUTUAL FUNDS

- Mutual funds historically have had a higher average expense ratio — 0.98%*

* Source: Morningstar. Data as of December, 2009. Average Prospectus Net Expense ratio for open end Index mutual funds as defined by Morningstar

ETFs vs. Mutual Funds

PRICING

TAX CONSEQUENCES

COSTS

▶ **MINIMUM INVESTMENT**

Minimum Investment

ETFs

- Have no investment minimums*

MUTUAL FUNDS

- May require investment minimums of \$2,500 or more**

* Subject to brokerage rules/ costs/ fees ** There are mutual funds that do not require investment minimums.

The Role of ETFs in Your Portfolio

ETFs can play a pivotal role in achieving your investment goals

Goal

▶ PROVIDE DIVERSIFICATION

BROADEN ASSET ALLOCATION

ENHANCE PORTFOLIO TAX
EFFICIENCY

ADJUST PORTFOLIO TO NEW
OBJECTIVES

TACTICALLY REPOSITION
PORTFOLIO

Provide More Diversification

Potentially add low cost diversification to almost any market segment: domestic, international, equities, fixed income, etc.

Diversification does not ensure a profit or guarantee against loss.

The Role of ETFs in Your Portfolio

Goal

- PROVIDE DIVERSIFICATION
- ▶ **BROADEN ASSET ALLOCATION**
- ENHANCE PORTFOLIO TAX EFFICIENCY
- ADJUST PORTFOLIO TO NEW OBJECTIVES
- TACTICALLY REPOSITION PORTFOLIO

Broaden Asset Allocation

Fill gaps in portfolio exposure: fixed income, international equities, domestic equities, REITs, commodities, precious metal, etc.

Asset allocation can not ensure a profit or guarantee against loss.

The Role of ETFs in Your Portfolio

Goal

PROVIDE DIVERSIFICATION

BROADEN ASSET ALLOCATION

▶ **ENHANCE PORTFOLIO TAX EFFICIENCY**

ADJUST PORTFOLIO TO NEW OBJECTIVES

TACTICALLY REPOSITION PORTFOLIO

Enhance Portfolio Tax Efficiency

ETFs are inherently tax efficient vehicles and can be effective for tax-loss planning

The Role of ETFs in Your Portfolio

Goal

PROVIDE DIVERSIFICATION

BROADEN ASSET ALLOCATION

ENHANCE PORTFOLIO TAX
EFFICIENCY

▶ **ADJUST PORTFOLIO TO NEW
OBJECTIVES**

TACTICALLY REPOSITION
PORTFOLIO

Adjust Portfolio to New Objectives

The precise nature of ETFs enables easy alignment with investor objectives

The Role of ETFs in Your Portfolio

Goal

PROVIDE DIVERSIFICATION

BROADEN ASSET ALLOCATION

ENHANCE PORTFOLIO TAX
EFFICIENCY

ADJUST PORTFOLIO TO NEW
OBJECTIVES

▶ **TACTICALLY REPOSITION
PORTFOLIO**

Tactically Reposition Portfolio

Liquidity, trading flexibility and low cost make ETFs effective for short-term portfolio repositioning

At liquidation, the value of an ETF may be worth more or less than the principal invested. Frequent trading of ETF's could significantly increase commissions and other costs such that they may offset any savings from low fees or costs.

Our Next Steps

Let's explore how ETFs potentially enhance your portfolio's performance

By adding

- Exposure to missing asset classes
- Potential diversification to reduce risk
- Lower cost vehicles

... while improving your portfolio's tax efficiency

Appendix: FAQs

FAQ

What are exchange traded funds?

A collection, or “basket”, of securities that typically track a specific market index; ETFs are similar to index mutual funds, possess the trading flexibility of individual stocks and are listed on major exchanges. They are not the same as mutual funds, however.

How can I buy or sell ETFs?

Investors can buy or sell ETFs through a brokerage, the same as stocks.

How does the performance of an ETF compare with the performance of its underlying index?

Exchange traded funds are designed to provide investment results that generally correspond to their underlying benchmark index by holding a portfolio of securities designed to give similar price and yield performance.

FAQ

Do I get paid dividends on ETFs?

ETF holders are eligible to receive their pro rata share of dividends, if any, accumulated on the stocks held in an ETF, and interest on the bonds held in an ETF, less fees and expenses. Of course, based on past performance, little, if any, dividend distributions can be expected on certain ETFs. There may also be the opportunity for dividend reinvestment.

What are the risks of investing in ETFs?

Equity-based ETFs are subject to risks similar to those of stocks; fixed income-based ETFs are subject to risks similar to those of bonds. Investment returns will fluctuate and are subject to market volatility. An investor's shares, when redeemed or sold, may be worth more or less than their original cost. Foreign investments have unique and greater risks than domestic investments. Past performance is no guarantee of future results.

What are the tax implications of trading index ETFs?

Trading an index ETF will trigger a gain or loss on a transaction. This gain or loss will be either ordinary or capital in nature, depending on the holding period. Dealers in securities will be treated differently, in that they utilize mark-to-market rules.

Disclosure

FOR PUBLIC USE.

ETFs trade like stocks, are subject to investment risk and will fluctuate in market value.

Investment decisions should be based on an individual's own goals, time horizon, and tolerance for risk.

Bond funds contain interest rate risk (as interest rates rise bond prices usually fall); the risk of issuer default; and inflation risk.

Past performance is no guarantee of future results.

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