T. Rowe Price

Six ETF Myths Debunked

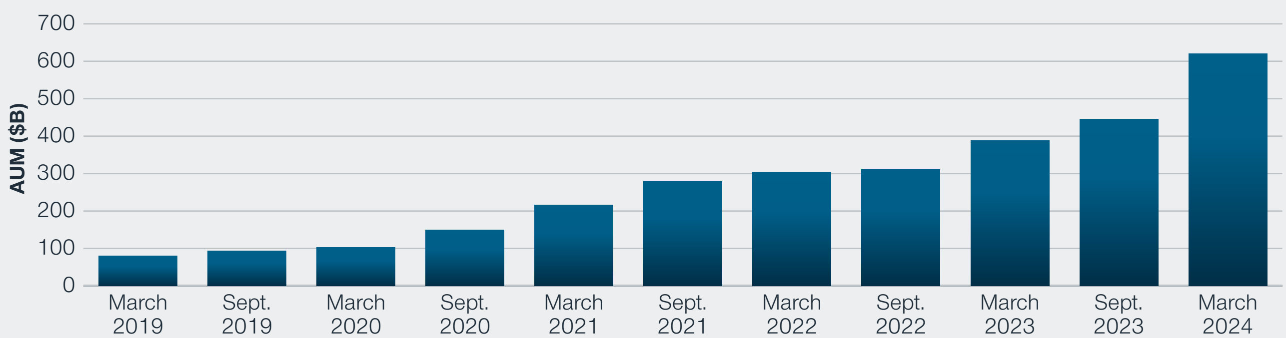
Exchange-traded funds (ETFs) have become a cornerstone of the investment landscape. Unfortunately, however, there are still a number of misconceptions about these products. We believe it's important to dispel these myths as they potentially could lead some investors to miss valuable additions to their portfolios.

With this in mind, here are six of the most common myths regarding ETFs:

Myth 1 All ETFs are based on passive strategies

When they were first developed, ETFs were strictly passive vehicles. Increasingly, though, more ETF offerings are actively managed, and there are now a variety of strategies available to investors across equity and fixed income asset classes.

Actively managed ETF assets have grown substantially in recent years.
Growth of Actively Managed ETF Assets Under Management,* March 2019 Through March 2024



*The chart illustrates the semi-annual total net assets of all actively managed ETFs traded within U.S. markets.
Source: Morningstar; analysis by T. Rowe Price.

Myth 2 Passive ETFs are safer than active ETFs

We believe that the level of risk depends on the underlying investments and not whether an ETF is passively or actively managed. That said, most active managers have the flexibility to conduct research and attempt to anticipate risks. Applying their professional experience and judgment when making security selections, active managers look for specific sectors or companies with greater upside potential and seek to avoid those with inappropriate downside risk. This approach is not possible with passive ETFs, which seek to track the stocks or bonds held in an index.

Myth 3 Active managers can't outperform index funds or passive ETFs

While it is true that not every fund manager can outperform their benchmark, some do. While all active managers strive to outperform their benchmarks, we believe those with global resources and research platforms may have an advantage leveraging their capabilities and experience. At the same time, economies of scale can help to keep fees and expenses in check.

Myth 4 ETFs are only for short-term trading and market timing

Although they can be bought and sold throughout the day without trading frequency limitations, ETFs are often intended for use over longer-term investment horizons. With fewer operational expenses than some other financial instruments, ETFs can be a cost-effective way to maintain exposure to various investment strategies over longer periods.

Myth 5 **ETFs should have full daily transparency of their underlying holdings**

Full daily transparency was originally viewed as necessary for an efficient ETF-trading process. However, the industry has evolved, and there are now several ways for ETF strategies to operate efficiently while maintaining a level of trading confidentiality. For some ETFs, shielding their investment-related intellectual property can be important to prevent outside investors and competitors from using the information in a way that may be detrimental to performance. However, not every investment strategy requires such shielding. For example, because of the way bond markets work, it's unlikely that competitors can gain a detrimental trading advantage by knowing the holdings of certain fixed income strategies.

Myth 6 **ETFs with low daily trading volume are not liquid**

An ETF's daily trading volume is not necessarily an indication of how liquid it is. Instead, it may be more informative to look to an ETF's underlying holdings when assessing liquidity. With holdings based in highly liquid markets, such as U.S. large-cap stocks, ETFs with low historical daily trading volumes can accommodate significantly higher volumes without causing major price swings. As a result, if the underlying holdings are highly liquid, the ETF should be liquid, as well.

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Conclusion

Contrary to the myths, active ETFs can play an important role in investor portfolios. Supported by fundamental research and managed by experienced professionals with a focus on security selection and careful attention to risk, we believe active ETFs could provide investors the opportunity for enhanced gains and the potential for appropriate downside risk management.

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Additional Disclosures

Important Information

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ETFs are bought and sold at market prices, not NAV. Investors generally incur the cost of the spread between the prices at which shares are bought and sold. Buying and selling shares may result in brokerage commissions, which will reduce returns.

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