In our years on Wall Street, our experiences led us both to independently form what would become the investment philosophy of Miracle Mile Advisors. We observed that active management did not work **consistently** over time for most investors. A portfolio manager would post shoot-out-the-lights performance one year, only to be followed by a bottom-quartile performance the next. It became frustrating to try to explain and defend these erratic performances to clients. Anecdotally, many of our colleagues had their personal money in passively-managed investments. They knew first hand that picking the top performing managers in the year ahead was nearly impossible, especially since it had little to do with the previous year's performance. In fact, it appeared that most of a portfolio's return was attributable to the asset classes in which it was invested.

When we built Miracle Mile Advisors, we anchored its foundations on these experiences. We agreed that the best way to serve our clients would be to provide them with a robust but simple, tax-efficient investment solution. *We have found that this is best accomplished with a globally diversified portfolio of Exchange Traded Funds (ETFs).* Since we began telling our story, we have come across many investors who already knew and loved ETFs for their transparency, tax-efficiency, and lower costs. There are still many others, though, who have either not heard of ETFs, or have misunderstandings about what they are. In this publication, we discuss some of the common misconceptions surrounding ETFs, and why we believe they are part of the best solution for an investor seeking a tax-efficient and diversified investment portfolio.

#1. I've never heard of Exchange Traded Funds. Are they new investments?

ETFs are a significant, and growing, component of the investment universe. The ETF was first introduced in 1993 with the creation of the Standard and Poor's Deposit Receipt (SPDR, commonly known as the "Spider"), which tracks the S&P 500 index. This is still the largest and arguably best-known ETF with $93.9 billion of assets, as of December 2008, but far from the only one. Shortly after we introduce someone to ETFs, almost without fail they tell us that they now notice hearing about them all the time. This is with good reason. At the end of 2008, U.S. investors had access to 758 listed ETFs totaling $534.5 billion, with another 525 prospectuses on file with the SEC. Although negative market movement caused total ETF assets to decrease in 2008, $178.4 billion in net inflows made them the fastest-growing area of the fund industry. Trading volumes for ETFs also skyrocketed. Almost $25 trillion worth of these funds were traded on U.S.-based exchanges in 2008, an increase of 70% over 2007. By comparison, the volume of U.S. equities (excluding ETFs) increased only 10% year-over-year.

	Dec 2006	Dec 2007	Dec 2008	% Chg. From 2007 to 2008
Number of Listed ETFs	380	646	758	17.3%
ETF Total Assets ($Mns)	$432,723	$617,733	$534,586	-13.5%
Net Annual Cash Flow	$72,296	$149,027	$178,395	19.7%
ETF Trading Volume	$6,776,788	$14,528,828	$24,739,958	70.3%

Source: IndexUniverse.com, National Stock Exchange℠

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#2. How are ETFs structured? Are they the same as mutual funds?

ETFs are one of the most straightforward and transparent investment vehicles available in the marketplace. Similar to a mutual fund, an Exchange Traded Fund generally holds a basket of securities, with each share representing a proportion of the underlying holdings (usually stocks or bonds). Both types of funds provide diversification in a single investment.

An important way that ETFs differentiate themselves from mutual funds is how they are traded and priced. When an investor buys shares of an open-end mutual fund, the fund company creates and issues new shares. The mutual fund is priced once per day with a "net asset value" (NAV), which reflects the value of the underlying holdings on that date. All buyers and sellers of a particular mutual fund pay/receive the same price on a given day, regardless of what time they order the transaction. That means that someone who sells their fund shares at 10am will receive the same price as a seller at 3pm, and neither will know the price until the end of the day when the NAV is calculated. Conversely, an ETF investor purchases existing shares from another investor on an exchange through a broker, similar to trading a stock. An ETF order can be placed and completed at any time during trading hours since the price is set by the market. No new shares need to be created.

Another difference between ETFs and most mutual funds is the way the underlying holdings are chosen and managed. A mutual fund (or separate account) is usually "actively managed," meaning the portfolio manager is trying to pick a group of stocks (or bonds) which will outperform a particular index[1]. Managers can try to perform better than the index using several methods, such as buying only a select subset of index constituents. They may buy these holdings at a different weighting than the index, placing more importance on those they believe will perform better, or they may even buy securities that are not in the index at all. These decisions are often based on researching companies' fundamental information, including balance sheets, management teams, product lineups, etc. Since much time and effort goes into researching these companies, active managers publish their portfolio holdings publically with a significant lag time.

Conversely, the vast majority of ETFs are "passively managed," meaning they aim to replicate the performance, dividend yield and risk characteristics of a particular index, such as the S&P 500. Some ETFs hold all of the securities in the index, but many use quantitative techniques to select a subset of holdings which together closely mirror the index characteristics. When the index provider makes changes to the underlying index, the ETF administrator may adjust the fund's holdings to make sure it is still representative. This is different from picking stocks on the basis of company fundamentals like an active manager would. An ETF administrator is merely trying to replicate the performance and risk of the index it tracks using a rule-based methodology. This also guarantees that an ETF will never deviate from its investment objective, which fits perfectly into an asset allocation strategy.

[1] Some mutual funds, called "index funds," are not actively managed. They try to replicate the performance of an index, but are still priced and traded in the same way as actively managed mutual funds.

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Since no proprietary research goes into the selection of ETF holdings, most providers publish fund holdings on a daily basis. An investor may go to the public websites of ETF providers such as iShares.com or WisdomTree.com, for example, and view all of the securities held by the fund as of the close of the previous trading day. This transparency makes it much easier for investors to know what they own and correctly analyze their level of diversification.

#3. How can I properly diversify with ETFs? Don't they just track major indexes? Can I buy bonds through ETFs?

ETF	Index it Tracks	ETF Assets ($Mns)
SPDR S&P 500 ETF (SPY)	S&P 500 index	$93,922
SPDR Gold ETF (GLD)	Price of Gold Bullion	$12,537
iShares MSCI Emerging Market ETF (EEM)	MSCI Emg. Market Index	$19,210
PowerShares QQQ ETF (QQQQ)	Nasdaq 100 index	$12,537
iShares Russell 2000 ETF (IWM)	Russell 2000 Small Cap Index	$11,018
iShares Barclays Aggregate ETF (AGG)	Barclays (formerly Lehman) U.S. Aggregate Bond Index	$9,522

Source: IndexUniverse.com, National Stock Exchange[SM]
As of December 2008

Some of the largest and most popular ETFs are shown in the chart at left. Today there are ETFs that replicate anything from a broad market index to a very specific, granular industry, such as Biotechnology or Alternative Energy, or even a currency or a metal like gold. An investor may build a portfolio of equities, fixed income and alternative assets diversified by geography, sector, industry, style, and market cap. ETF investors can even buy funds that are levered to produce returns two or three times the underlying index, as well as "go short". There are also ETFs that are more heavily weighted toward dividend paying stocks for extra income generation, which may be particularly attractive in the current low-return environment.

ETFs* by Category ($Mns)	Dec 2007	Dec 2008
U.S. Equity	$372,706	$329,259
Global/International Equity	$182,969	$112,937
Fixed Income	$34,681	$57,035
Commodity	$28,536	$36,175
Currency	$3,683	$3,642
Total	**$622,574**	**$539,049**

**Includes Exchange Traded Notes*

Not only do ETFs track almost every imaginable asset class, there may be multiple ETFs that represent the same asset class. It is important to thoroughly examine an ETF investment by researching the issuing company, fund structure, fees, and correlation to the underlying index.

The fixed income market place is expanding rapidly. Less than 25 years ago Treasury bond and municipal bonds made up over half of the fixed income market. By the end of 2007, they accounted for less than 15% as the corporate and asset-backed areas have grown markedly. New bond ETFs are continually coming to market to facilitate access to these areas. Owning bonds through an ETF provides several benefits. First, they provide better diversification than owning individual bonds for the same level of investment. Second, trading bonds is not as transparent as trading individual stocks. Owning them through an ETF structure provides better transparency on pricing and liquidity.

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Bond ETFs are structured similarly to equity ETFs. They own a portfolio of bonds that is designed to track the duration, maturity and yield characteristics of an index. ETFs are similar to bond funds in the sense that the underlying holdings never mature. Investors receive coupon payments just as they would if they held the underlying bonds.

#4. Why can't I just invest in the index? Why do I have to pay a fee for an ETF?

It is not possible to invest directly in an index since it is not itself a tradable investment. The creation of a valid investment vehicle requires significant administration by the issuer, which is where ETF fees come in. The fees charged by ETFs, however, are typically much lower than those required to invest in a mutual fund. Mutual funds companies may charge a variety of fees to purchase their funds. A common fee is the "sales load," which may appear in several different formats. A front-end sales load is charged as a percentage of the assets invested, and is paid at the time of purchase. Alternatively there may be a deferred sales load, or back-end load, charged over time. Even a no-load fund may include fees; they may charge purchase fees, redemption fees, exchange fees, or account fees. (Please see the SEC website for more info about mutual fund fees and expenses http://www.sec.gov/answers/mffees.htm#salesloads.)

This table compares the fees of several popular U.S. mutual funds, some with sales loads and some without, against the fees of an ETF that tracks the benchmark index of the funds.

	Annual Net Expense Ratio	Maximum Front End Sales Load	Maximum Deferred Sales Load
U.S. Large Cap Equity			
SPDR S&P 500 ETF	0.09%		
No load fund	0.56%		
Load fund			
Class A Shares	0.55%	5.75%	
Class B Shares[1]	1.33%	0.00%	5.00%
Class C Shares[2]	1.38%	0.00%	1.00%
International Equity			
iShares MSCI EAFE ETF	0.34%		
Load fund			
Class A Shares	1.16%	5.75%	
Class B Shares[1]	1.91%	0.00%	4.00%
Class C Shares	1.90%	0.00%	1.00%
U.S. Fixed Income			
iShares Barclays Aggregate Bond Fund	0.24%		
No load fund	0.45%		
Load fund			
Class A Shares	0.90%	3.75%	0.00%
Class B Shares[3]	1.70%	0.00%	3.50%
Class C Shares[2]	1.71%	0.00%	1.00%

Source: State Street Global Advisors, Barclays iShares, Schwab Institutional

1 Some portion of max deferred sales load charged if shares sold within 6 years of purchase.

2 Some portion of max deferred sales load charged if shares sold within 1 year of purchase.

3 Max deferred sales load charged if shares sold within 1 year of purchase, gradually declining to zero in year 6.

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#5. Are ETFs considered an asset class? How do they perform versus active managers?

Something that we hear over and over again, even in the financial press, are comments that imply ETFs themselves are an asset class. ETFs are **not** an asset class, they are a type of investment vehicle. A generalization like "ETFs performed well today" is misleading, and makes no more sense than saying "mutual funds were down today." An ETF's performance is linked to the index it tracks. In the same time period an ETF that tracks a small cap equity index may be down, while an ETF that tracks gold may be up. It depends on the performance of the underlying assets.

The data show that ETFs generally perform better than actively-managed funds after taxes and fees. Although active managers have the tools at their disposal to outperform their passive index benchmarks, they fail a majority of the time. This is a problem since, in theory, investors pay higher fees for active management in order to generate returns that beat the benchmark.

According to Morningstar, 58% of all actively-managed funds underperformed their benchmark index in 2008. Large-cap U.S. equity funds lagged the S&P 500 index at a rate of 62%, as did 63% of all U.S. diversified equity funds. Conventional wisdom states that funds which invest in "less efficient" areas of the market where information is less freely available have a better chance of beating their benchmark. This did not bear out in 2008 either. In fact, 72% of small-cap managers performed worse than their benchmarks.

History does not bode well for active management, even if the market begins to stage a recovery. After the last recession ended in late 2001, the U.S. equity market began to rebound in October 2002. In the 12 months that followed, 78% of U.S. managed equity funds underperformed their benchmarks. Once tax implications are considered for individual investors, even fewer mutual funds reach the hurdle of outperforming their benchmarks.

#6. Do I still receive dividend payments if I own an ETF? What are the tax consequences?

Not only does an ETF aim to replicate index performance, it also tries to mirror the dividend yield. An investor in an ETF receives a proportional share of the dividends paid out by the underlying stocks. Dividends paid out by the underlying stocks accrue with the custodian, and are then passed on to the investor in regular payments throughout the year.

There are several ways that ETFs are more tax-efficient for individual investors. First is the "creation/redemption" methodology used to get rid of holdings that might otherwise incur capital gains. Like a mutual fund, if the shares of the underlying stocks in an ETF increase in value, there would be an accumulated capital gain. If these winners were sold, a gain would be booked causing a taxable event. The benefit of ETFs is that there are professional market makers who buy ETF shares and then deliver them to the ETF provider in exchange for the equivalent value in the ETF's holdings. For example, if the market maker bought up shares of the SPDR ETF, which tracks the S&P 500 index, the ETF shares would be delivered to the ETF provider and the market maker would receive shares of each of the underlying stocks held by the ETF. This "in-kind" redemption allows the ETF to unload stocks that have incurred gains in a more tax-efficient manner.

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Another tax benefit of ETFs is that investors are unaffected by other investors buying and selling shares of the ETF. Imagine that Jane and John both own shares of ABC Mutual Fund. One day, John decides he wants to sell his ABC shares to raise cash. Since mutual fund shares are not traded between investors, John sells his shares back to the fund company which then eliminates his shares. In order to raise the cash required to pay John, the manager must sell holdings in the fund. If any of these holdings have gone up in value since purchase, this causes a taxable event for the remaining shareholders. In this scenario, Jane may have to pay taxes on gains even though she did not sell her shares. Many investors felt this pinch at tax time in 2008 when they paid taxes on gains generated in late 2007 just as the market began to fall and investors bailed out. Since shares of ETFs are traded on the open market between investors, they do not bear a tax burden from other investors buying and selling.

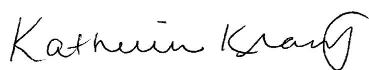
Conclusion

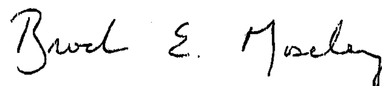
In these challenging economic times, people want easy access to their money and a clear investment strategy. **No investment tool available today provides better liquidity and transparency than ETFs.** Given these objectives, we believe that ETFs are now, more than ever, the smartest tool for populating our global investment strategy.

In all market conditions, ETFs provide:

- A pure asset class return, which allows us to generate outperformance through our strategic and opportunistic allocation decisions.
- Protection from a star fund manager leaving to pursue other interests.
- Liquidity and diversification to clients who have investments such as real estate and private equity.
- Cost and tax advantages for individual investors.

January 27, 2008





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