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Diversifying Your Portfolio Using ETFs

If you're looking to instantly diversify your portfolio, you may come across the decision of choosing between an ETF and a mutual fund. ETFs are one of the best substitutes to mutual funds. The prime reason for this is their low cost. Most ETFs have a management fee of less than 1%. Large index ETFs can have fees less than .25%. Unlike mutual funds, ETFs are traded throughout the day which gives the trader a superior advantage if you need to make a trade fast.

Over the last ten years the ETF industry has exploded and become very lucrative to sponsoring firms. Many competitors have rushed into the market creating ETFs in very niche industries. There are over 1,000 ETFs ranging from broad market objectives to very specialized technology. Finding the right ETFs for your portfolio is now almost as challenging as selecting superior stocks.

When you build your portfolio of ETFs it is important to understand its underlying assets and not base your decision on the title of the ETF. For example just because an ETF represents India, doesn't mean it is the same as another ETF representing India. IIF is an India fund that invests in infrastructure companies, where IFN focuses more on service related companies. Other ETFs may be structured where one company can account for 60% of the whole fund. Knowing about this lack of diversification, you may think twice about owning that ETF and look to other options.

After you have selected your group of ETFs, it would be prudent to dollar cost average into them. This means that you have a set dollar amount that you buy on a consistent basis. This will ensure that you buy more shares when the fund goes down and less shares when the fund goes up. Over time you should have a very attractive cost basis. Stick to a long-term strategy. Over time you should be able to do quite well.