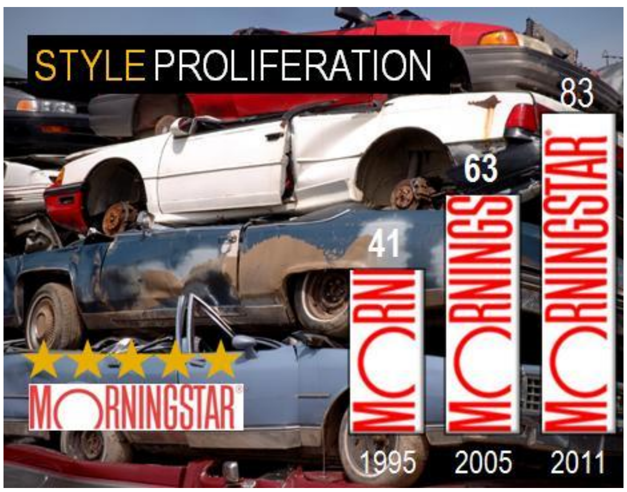
Mutual funds distort what your clients think is important by emphasizing performance. But everyone knows that past performance is no indication or guarantee of future performance. Total return rankings are distorted by survivor bias with poor performing funds getting folded into better performing ones.

ETFs do not compete based on performance. Comparisons relate to asset mix, index construction and costs, things that actually matter. When an ETF fails, it does so not because of poor performance, but because investors do not embrace its underlying index and it is closed. There is nothing left behind to distort evaluations. It's just more honest.



Managers hate to be put in boxes so they create niche benchmarks that they try to beat. Morningstar has 83 mutual fund categories with 53 in Canada, too much choice and no real benefit to investors. These are not new asset classes, just more fund categories. The star ranking system is for the intellectually lazy. Studies show that if they offer a benefit, the top ranked funds are those with lower costs. This is a good tip for ETF buyers.

Mutual funds distract investors by drawing attention away from the things that really matter, asset mix, risk and costs.

By concentrating on historical performance, mutual funds create an environment to sell last year's best performing funds ignoring the client's best interests.

ETFs have elevated the discussion by focussing on the things that actually matter to investors, asset mix, the risk of assets, and above all, costs.

The ETF Screener found on the TMX Money website can help investors navigate the growing number of ETFs in the marketplace. After screening by conventional categories, all ETFs are ranked by the five criteria in the bottom panel. The top ranked shown towards the top of each category. Scrolling over a dot reveals the ETF and shows its relative position in the other categories. The list can be displayed sorted and printed.

Portfolio Size	Number of ETFs
$50K or less	4-5
$50k-100k	7-8
$100k-$250k	9-10
$250k-$500k	10-15
$500k or over	15-20+

How many ETFs are needed for a diversified portfolio? The table to the left is a good guideline. Of course investment style has much to say about this.

While most ETFs are well diversified, larger portfolios may benefit from incremental diversification by holding more granular index components. Getting the composite risk right is the key.

How many trades are required to effectively rebalance to a consistent risk? We found that between fifteen and twenty trades can add up to 4% to portfolio returns. Beyond twenty and the advantage diminishes.

If things go wrong it is usually a deficiency in diversification, lack of liquidity, poor tax efficiency or high tracking error. All these things impact costs.

Get to know the underlying assets in an ETF. If you do you will never be surprised or disappointed.