

db x-trackers

Simply buy the market



db x-trackers ETFs – Quality made by Deutsche Bank

A 10 Step Guide to Exchange Traded Funds

A Passion to Perform.

Deutsche Bank



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Introduction

Exchange Traded Funds (ETFs)

have become a phenomenal global success and continue to soar in popularity as one of the fastest growing investment products of recent times. In 2008 the assets under management (AUM) for investment funds in Europe fell by 22% whereas the AUM for ETFs in Europe increased by 23%¹. Trading volumes for ETFs are also increasing – the value of ETFs traded on the London Stock Exchange have increased by almost 80% since 2007 while the number of trades has more than doubled².

Their huge popularity can be attributed to their low cost, accessibility, flexibility, diversity, transparency and liquidity; all features that investors typically see as key in a desirable investment vehicle.

Your existing holdings in investment funds and pension funds are in all likelihood using ETFs to some extent. However, you may now like to look at how you and your financial adviser can use ETFs in a more direct way. This 10 Step Guide introduces you to the world of ETFs and takes you through the main elements you need to understand (including the risks) before possibly investing. Please note that after reading this guide you should always read the relevant

prospectus that describe a particular ETF and discuss with your financial advisor to ensure you understand the characteristics, investment strategy and risks of that ETF before investing.

The ETF market continues to develop at a rapid pace as providers and advisers identify new ways for them to be used for all types of investors. Whatever the area or sector of the investible universe that you think you might like to invest in, there is likely to be an ETF already available for you, and many others that you may not yet have considered that can help reshape and enhance your portfolio. However, please also take into consideration that some ETFs are only appropriate for sophisticated investors.

This guide from **db x-trackers**, the ETF range from Deutsche Bank, offers a plain language introduction to their features, possible benefits, risks and uses for all investors and shows how you can simply “buy the market” with an ETF.

This guide does not constitute investment advice as explained more fully in the disclaimer on page 18 of this guide.

¹ Source: Barclays Global Investors ETF Industry Preview
² Source: London Stock Exchange Monthly Trading Volume Data





Step 1 – What are ETFs?

In essence, ETFs are very low cost, diversified funds that trade as a single security whilst giving you exposure to the components of an index in which you wish to invest. They combine the tradability and liquidity advantages of stocks with the low costs and diversification benefits of index funds in one product.

ETFs are therefore a simple and straightforward way for any investor to gain instant diversified exposure to a particular market, region, sector, asset class and current investment strategy, all through one simple transaction. If you want to invest or rebalance part of your portfolio towards the US, the Far East, European small companies, telecoms,

natural resources, fixed interest, healthcare, utilities – (the list is extensive), then you can simply “buy the market” that you want, when you want, through an ETF.

Most ETFs can be held in an ISA or SIPP and most are also regulated as authorised open-ended investment funds, yet with the key additional advantage that they can be traded ‘intra-day’ (throughout the trading day) on the stock exchange in the same way as any other listed tradable security.

- One of the most cost effective ways to invest
- Instant market access at very low cost
- Trade intra-day





Step 2 – How do ETFs work?

ETFs are structured as open-ended investment funds and can be traded intra-day on the London Stock Exchange (“LSE”).

Most ETFs are passive investments and are not actively managed by a fund manager. The aim of these passively managed ETFs is to simply mirror or replicate an index that represents a particular market, such as the UK FTSE All Share, or a specific sector such as the DJ STOXX® 600 Banks (an index which represents the largest European companies in the banking sector).

There are a wide variety of indices in existence today and more are being created that allow products like ETFs to track or reflect the entire underlying combined value of all the individual companies or securities that make up a particular index.

There are two methods used by ETFs to track the performance of an index. The first method typically involves holding some or all of the components of the relevant index to track the performance. The other method replicates the index performance “synthetically” through an over the counter (OTC) index swap transaction with a counterparty such as an investment bank.

Both methods are used by the leading ETF providers in Europe. The db x-trackers range of ETFs track the index through synthetic replication and fall into the second type of ETF with Deutsche Bank as the counterparty.

The returns of ETFs also include income distributions which are either paid out at regular intervals or automatically reinvested.

- Exposure to an index through a regulated fund that trades as a share
- Dividends included in the returns of an ETF
- ETFs can provide near-perfect tracking of an index before fees



Step 3 – How can I invest in ETFs?

ETF shares can be invested in easily through your broker or via a fund or wrap platform or other online dealing services. They trade and settle through the local clearing system in the same way as any other listed tradable security with no set up documentation or specific infrastructure required.

Unlike an “active” mutual fund where you are paying an extra layer of fees for a fund manager to select stocks as they aim to outperform an index or benchmark, an ETF is a “passive” fund that just tracks the index you want, without the associated additional costs for active fund management.

Most mutual funds will deal only once a day at a forward point, on either the same or the following day from when you deal and also at an unknown valuation from the time you place the order. ETFs, however, can be traded at any time and at any size at the price you see and agree to. ETFs therefore provide certainty; certainty that you are dealing at a known price and certainty that you are getting what you want to invest in.

- Buy or sell through your broker, platform or dealing service
- Trade and settle the same as any stock exchange listed and traded security
- Easy to set up and trade



Step 4 – What are the costs of using ETFs?

The long term impact or drag on performance of high management fees is now more widely recognised. Reducing the overall costs on your portfolio is therefore a key objective for investors and advisers and it is here that ETFs can help you increase the total returns on your investments over time.

Compared to those on active funds and even traditional index tracking funds, the annual management fees and running costs on ETFs are extremely competitive and are known as the “All In Fee.” These are capped at a maximum level. For example, the annual All In Fees for the db x-trackers Sterling Money Market ETFs are 0.15% and just 0.30% for the db x-trackers FTSE 100 ETF.

There are no upfront or exit fees for ETFs and there is also no stamp duty on buying ETFs on the London Stock Exchange. Other than normal trading commissions that would be charged by brokers for trading shares, in most cases there are no additional charges associated with buying,

selling or holding ETF shares in your portfolio other than the usual arrangements you may have with your financial adviser.

- Low All In Fees
- Low transaction fees for trading on the stock exchange
- No stamp duty on LSE-listed ETFs
- No upfront or exit fund fees

Impact of fees on long term performance

With long-term investments the fee structure has a significant impact on an investment’s performance. Take for example a one-off investment of £20,000 with an annual return of 8% p.a. for 20 years. Assuming a management fee of 1.5% p.a. this would return a final sum of £70,472.90, while with a lower management fee of 0.5% p.a. the final sum would be £84,957.02 over £14,000 more just from a lower fee structure!



Step 5 – Pricing Efficiency and Liquidity of ETFs

A feature of the efficiency that ETFs offer is that the price of an ETF is constantly kept very close to its true and fair value by authorised market-making firms who correct any minor premium or discount that may occur in the price during trading on an exchange. These market making firms can correct any supply or demand imbalances that can cause the price of the ETF to be at a premium or discount to the fair value.

This has advantages for both large and small investors as trades can be made in any size, even for very large orders without there being any market impact. This contrasts to the situation with other types of mutual funds, where a single large order on its own or many small orders combined together may have a negative effect which can trigger an increase in the price paid to invest or a decrease in the price received if redeeming in size.

The pricing of ETFs therefore tends to be both efficient and transparent. Many ETFs publish an iNAV or Indicative Net Asset Value which is calculated and updated to reflect real time movements of the index being tracked. In most cases the bid/offer quotes for an ETF share on the stock exchange will move in line with its iNAV.

ETFs are truly transparent and you know what you are investing in as the implied underlying portfolio is updated and there for all to see on a daily basis, unlike most mutual funds that are only obliged to disclose their full holdings twice a year.

- Transparent, continuous and efficient intra-day pricing on the stock exchange
- Instant access and no premiums/ discounts to fair value
- Flexible – easy to trade in small and large sizes, typically without market impact



S&P 500
Short



Step 6 – What types of ETFs are available?

On the LSE there are over 200 ETFs available, including many areas that were previously difficult to access or simply beyond the scope and means of many investors. Now through the simplicity and efficiency of ETFs, investors can access:

1. **Developed markets** – UK, USA, Europe, Japan, world
2. **Emerging markets** – regional and individual countries, e.g., India, China and Brazil
3. **Different investment styles** – value/growth, small/mid cap, high dividends
4. **Fixed Income** – government bond
5. **Shariah-Compliant** – Global, US, European, Japanese indices
6. **Money market and currencies** – track overnight money market rates for major currencies – Euro, US Dollar, Sterling
7. **Commodities** – diversified indices covering a wide range of commodities
8. **Investment themes and sectors** – e.g., infrastructure, healthcare
9. **Alternative investments** – hedge fund and private equity indices
10. **Short and leveraged index ETFs** – for financially sophisticated investors who want to use ETFs as a short term day trading tool to hedge their portfolio or take contrarian views


As ETFs are becoming ever more specific in the areas they cover, investors and advisers can now be very precise in their portfolio construction and asset allocation.

- ETFs provide access to mainstream areas as well as those only previously available to specialised investors.
- The pace of development and innovation in ETFs continues at a rapid rate.



Step 7– Understanding the Risks of ETFs

Very few if any investments today can be truly thought of as risk-free, and ETFs are no different. They will track an index very closely, both up and down in value. There is also a potential risk that can lie in the structure of all ETFs, often referred to as the counterparty risk which is a feature of almost every ETF in some form.



In reality however, an ETF (such as the db x-trackers ETF range) or any other mutual fund that is structured under the Europe-wide UCITS III (Undertaking for Collective Investments in Transferable Securities) regulations is subject to various diversification requirements and limits on counterparty exposure. These regulations apply to both methods of index replication for ETFs described under Step 2 and cover aspects such as portfolio diversification requirements and limits on counterparty exposure in relation to securities lending activities (typically used by ETFs that replicate the index performance by holding some or all of the

components of the relevant index) and OTC derivative transactions (typically used by ETFs that track the index performance through synthetic replication).

There are specified limits on counterparty exposure for the synthetic replication type of ETFs like db x-trackers. Under the UCITS regulations, the maximum exposure to an OTC derivative counterparty is 10% of the Net Asset Value (NAV) of the fund. What this means in practice is if the counterparty defaults, the fund would be liquidated and investors should get at least 90% of the NAV at the time of liquidation. This does not necessarily mean an investor will get back 90% of the amount originally invested. The amount received would depend on the performance of the underlying index which may have fallen over the period of investment.

The investment risks relating to db x-trackers ETFs are outlined on page 14.



Step 8 – Understanding the Taxation of ETFs

ETFs can be used by a wide variety of investors and can form part of an ISA or pension through a self-invested pension plan (“SIPP”).

Outside of these tax wrappers, they can still be used for tax planning as many ETFs listed on the London Stock Exchange have ‘distributor status’. This means that any gains made in excess of your annual personal exempt tax-free capital gain amount are generally liable to Capital Gains Tax, currently at just 18%, rather than at your much higher marginal rate of income tax.

Gains on ETFs without distributor status are taxed as income so it is worth checking and if you are in any doubt you should always consult with your professional adviser before investing.

As mentioned in Step 4 there is no stamp duty applied to the buying of ETFs on the London Stock Exchange.

- ETFs can be held in an ISA or SIPP
- ETFs can be used to maximize tax efficiency through their distributor status

If you have any questions on the taxation of ETFs you should contact your professional adviser.




Step 9 – ETFs in active portfolio management

ETFs are a flexible investment tool that can be used in a variety of ways which can be determined by adviser and investor working together. For example, unlike traditional mutual funds, ETFs can be used to protect your portfolio by putting in place “stop limits” on your ETF which are pre-set price points that you have determined will provide you with an acceptable profit or that you do not wish the price to fall below.

Passive instruments such as ETFs can help reduce costs and enhance returns in portfolios. For most investors, ETFs can play a very valuable role by forming the low cost part of the ‘core’ in a core/satellite portfolio asset allocation strategy. By using active managed funds as the respective ‘satellites’ of the core portfolio, investors and advisers can blend the best of both active and passive approaches. Alternatively, the reverse is equally applicable and ETFs themselves can be used as satellites to allow investors to participate in otherwise hard-to-access markets or new asset classes.

The trend in Europe towards fee-based investment advisory and ‘wrap’ services will benefit from the growth of ETFs as they can be considered as valuable, low cost components for almost any investment portfolio, enabling advisers to add further value to the services they provide to clients.

- Combining active and passive funds can significantly reduce costs
- ETFs can be used as part of an active portfolio
- ETFs can fulfill either the core or satellite component



Step 10 – Ten ways to use ETFs

As ETF shares can be traded intra-day and are transparent, they are a highly flexible investment tool for achieving index exposure on both a long and short term basis. Below are ten ways in which any investor can use ETFs:

1. Asset allocation – both on a tactical and strategic basis
2. Gain exposure to new markets and alternative asset classes
3. Core-satellite strategy – use ETFs as the core or satellites to reduce costs
4. Short term cash flow management
5. Diversification and risk management
6. Boosting performance and efficiency of portfolios
7. Combine ETFs with active funds or stock picking strategies
8. Investing in short or long term market trends
9. Effective tax planning through ISAs and SIPPs
10. By blending together active and passive funds in your portfolio it could be possible to achieve a reduced overall level of cost for the same level of opportunity.

We hope this 10 Step Guide has given you some useful insights into the world of exchange traded funds. If you would like to learn more about how ETFs could be used in your portfolio, please contact your usual financial adviser. You may wish to visit the db x-trackers website on www.dbxtrackers.com where you will find further useful information and portfolio building tools to help you simply 'buy the market' of your choice.



Investment risks relating to db x-trackers ETFs

- Investment in db x-trackers ETFs involve numerous risks including among others, general market risks relating to the relevant index, credit risks on the provider of index swaps utilised in the db x-trackers ETFs, exchange rate risks, interest rate risks, inflationary risks, liquidity risks and legal and regulatory risks.
- The db x-trackers ETFs use Deutsche Bank as the counterparty for OTC derivative transactions. In the event of a default under the terms of the OTC derivative transaction by Deutsche Bank, the db x-trackers ETFs would be liquidated and investors could lose up to 10% of the NAV of the ETF. The NAV at the time of default may be considerably less than the amount an investor originally invested depending on the performance of the relevant underlying index. You should therefore understand and evaluate the counterparty credit risk prior to making any investment.
- The value of an investment in a db x-trackers ETF may go down as well as up and past performance is not a guide to the future.
- db x-trackers may trade in limited markets.
- db x-trackers may be unable to replicate precisely the performance of an index.
- Investors' income is not fixed and may fluctuate.
- The value of any investment involving exposure to foreign currencies can be affected by exchange rate movements.
- ETFs shares may be denominated in a currency different to that of the traded currency on the stock exchange in which case exchange rate fluctuations may have a negative effect on the returns of the fund.
- Tax treatment of the db x-trackers ETFs depends on the individual circumstances of each investor. The levels and bases of, and any applicable relief from, taxation can change.
- For further information regarding risk factors, please refer to the risk factors section of the listing particulars or full prospectus.



Investors should note that the db x-trackers ETFs are not capital protected or guaranteed and investors in each db x-trackers ETF should be prepared and able to sustain losses of the capital invested up to a total loss.

An investment in a db x-trackers ETF tracking a leveraged or short index is intended for financially sophisticated investors who wish to take a very short term view on the underlying index, e.g., for day trading purposes. Therefore the db x-trackers ETFs on leveraged or

short indices are appropriate only for financially sophisticated investors who understand the strategy, characteristics and risks. The db x-trackers ETFs on leveraged or short indices are not intended to be a buy and hold investment.

Please refer to the db x-trackers full prospectus and any relevant simplified prospectus for more information on db x-trackers ETFs. These documents are available free of charge from Deutsche Bank (see contact details on the back cover).



About db x-trackers ETFs

db x-trackers is Deutsche Bank's Exchange Traded Funds (ETFs) index tracking solution platform. db x-trackers was launched in January 2007 and is currently the fastest growing ETF provider in Europe. Over £20 billion of assets under management have been raised making db x-trackers one of the three largest ETF providers in Europe.

db x-trackers' ETFs are listed on six different exchanges across Europe and Asia (Borsa Italiana, Frankfurt Xetra, Paris Euronext, London Stock Exchange, Zurich SIX Swiss Exchange and Singapore Exchange SGX) and are supported by multiple market makers.

On the London Stock Exchange, db x-trackers offers over 60 ETFs covering equity, fixed income, credit, money markets and commodities; enabling anyone the opportunity to invest in a highly transparent, flexible and efficient way. The range includes the only ETFs in the UK to offer money market, sector or short exposure, products which have proven to be very popular with investors across Europe.

db x-trackers ETFs are domiciled in Luxembourg and comply with UCITS III regulations.

All of the above data was correct as at June 2009.

Further Product Information

Further product information on the db x-trackers ETFs, including the simplified and full prospectus are available on the website:

www.dbxtrackers.com

Alternatively you can contact us in writing, by telephone or by email on the details provided below.

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Important Information

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This brochure contains a short summary description of the above mentioned ETFs and is for discussion purposes only. A complete description of the funds is in the respective and most recent prospectus of the above mentioned ETFs. This brochure is not for distribution to, or for the attention of, US or Canadian persons. Without limitation, this brochure does not constitute an offer or a recommendation to enter into any transaction. When making an investment decision, you should rely solely on the final documentation and any prospectus relating to the transaction and not this summary. Investment strategies involve numerous risks. Prospective investors or counterparties should discuss with their professional tax, legal, accounting and other adviser(s) the effect of any transaction they may enter into, including the possible risks and benefits of such transaction and should ensure that they fully understand the transaction and have made an independent assessment of the appropriateness of such

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A full description of the terms and conditions of all sub-funds are included in the prospectus of db x-trackers and db x-trackers II. You can get the full and the simplified prospectus of each sub-fund of db x-trackers at db x-trackers, 49, avenue J.F. Kennedy, L-1855 Luxembourg, R.C.S. Luxembourg D-119 899.

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Further Product Information

Further product information on the db x-trackers ETFs, including the simplified and full prospectus are available on the website:

www.dbxtrackers.com

Alternatively you can contact us in writing, by telephone or by email on the details provided below.

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